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CHARLES ELMORE CROPLEY
CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

_____ Term, 1949

No. 740

LENA SIMONSEN,

Petitioner,

vs.

JOHN W. EMMERLING, Trustee of
FRANKLIN BUILDING COMPANY,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF

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HAMMERSMITH-KORTMEYER CO. MILWAUKEE

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Summary of Argument:

I. Bankruptcy Court in applying its statutory power of limitation-to-cost under Sec. 212, Chapter X, of the Bankruptcy Act, 11 U.S.C.A. 612, must do so within the limits of that statute, and in the absence of findings that claims were acquired fraudulently and in contemplation of the pending proceeding, or used in bad faith in that proceeding, it cannot limit-to-cost claims acquired by fiduciaries 10-13

(a) Trial court and Court of Appeals did not find that claimant's husband, while a member of the bondholders' committee, acted covertly or traded on inside knowledge in acquisition of bonds, or that such purchases

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affected his loyalty or prejudiced the interests of the debtor or other bondholders. On the contrary, both courts found good faith conduct in such acquisition and in the discharge of his duties as a member of the committee 10

(b) Most of $8,000 of bonds acquired by claimant's husband while he was a member of bondholders' committee were acquired about ten years prior to institution of these reorganization proceedings, and the last of them about five years before that, and these proceedings were not started until two and one-half years after death of claimant's husband 12

II. If Bankruptcy Court can go beyond the power provided in the statute and apply the equity rule of limitation-to-cost in such cases, it must follow rule of "good faith conduct" as laid down by this Court in Manufacturers Trust Co. v. Becker, 94 L. Ed. 99, and Securities & Exchange Commission v. Chenery, 318 U.S. 80, and not the absolute rule of Magruder v. Drury, 235 U.S. 106 13-17

III. Bankruptcy Court should not have disregarded the provision in the agreement under which the committee acted which made the members liable only for actual bad faith, and which did not proscribe purchase of bonds by committee members 17-18

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

To the Honorable Fred M. Vinson, Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Your Petitioner, Lena Simonsen, by her counsel respectfully represents to this Honorable Court:

SUMMARY STATEMENT OF THE MATTER INVOLVED

The petitioner filed a claim in this proceeding under Chapter X of the Bankruptcy Act for the reorganization of Franklin Building Company, a corporation, Debtor, in the principal amount of $11,500.00 on account of first mortgage leasehold bonds of such debtor, $3500.00 of

which was acquired by her personally prior to 1935 and $8000.00 of which she inherited from her husband, William Simonsen, which he acquired by purchase through brokers at a total cost of $871.71 between February 9, 1937, and November 20, 1942, as follows: $5500.00 in 1937, $1500.00 in 1938, $500.00 in 1940, and $500.00 in 1942.

The debtor, Franklin Building Company, a corporation organized in 1929, owned a store and office building in the City of Milwaukee, Wisconsin, covered by a first mortgage leasehold bond issue upon which there was due in 1931 $244,400.00 principal amount and after default in the terms of the mortgage an agreement was entered into between the company and a bondholders' committee, on the 23rd day of February, 1932, under which the committee was to manage the building through a trustee chosen by it, for a period of five years to September 1, 1937, until the interest on the mortgage was on a current basis, when the operation of the company would revert to the company, but if default continued then the procedure was to last another five years (R. 26). On September 1, 1937, by agreement, the management of the building by the bondholders' committee was continued for an additional five years to September 1, 1942 (R. 27) and on September 1, 1942, it was agreed that the committee continue to operate the building. The committee's management continued right up to the time of the filing of this proceeding. At the time the bondholders' committee took over, the financial condition of the debtor was bad, its building was only half completed, (R. 27) and there were unpaid delinquent taxes against it in the amount of $42,000.00, exclusive of penalties. Its rents from the building and its bank account were garnisheed, and the unpaid public utilities were refusing to furnish electric and gas service (R. 39).

During this period of approximately fifteen years the committee managed the building (R. 27), collected the rents, paid up all delinquent taxes, which together with penalties amounted to about $66,000.00 (R. 39), and also completed the building for which was spent nearly $100,000.00 of the rents (R. 39).

Although the record does not include the particular proceeding, the building was sold in these proceedings and it appeared from the trustee's brief filed with the Circuit Court of Appeals that there probably would be paid out in distribution in these proceedings 140% of the principal amount of the first mortgage leasehold bonds.

Petitioner is the widow and heir-at-law of William Simonsen, who became a member of such bondholders' committee in the year 1935 and acted on the committee to the date of his death on November 14, 1944.

Debtor filed its petition herein for reorganization on May 5, 1947 (R. 2 to 5 incl.), almost three years after the death of William Simonsen.

The District Court allowed her claim in full on the first listed of the above bonds purchased by her at the time of the original issue thereof, and limited her claim on the other $8,000.00 par value of bonds inherited through her husband to $871.71 (R. 184, 185).

In its decision or order of limitation the District Court made no finding that the bonds thus limited were acquired by William Simonsen in contemplation of the proceeding, or that in acquiring them he was guilty of conduct amounting to bad faith or abuse of fiduciary advantage.

The Court of Appeals affirmed such order.

JURISDICTIONAL STATEMENT

It is contended that the Supreme Court has jurisdiction to review the judgment here in question because the Court of Appeals of the Seventh Circuit (a) has decided an important question of Federal law which has not been but should be settled by this court; (b) has decided a Federal question in a way probably in conflict with applicable decisions on this Court.

QUESTIONS PRESENTED

The following questions are presented:

(a) Is the bankruptcy court's discretionary power under Section 212, Chapter X, of the Bankruptcy Act, 11 U.S.C.A. Sec. 612, to limit-to-cost claims acquired by a member of a bondholders' committee, acting under an agreement with the debtor to manage its building covered by the bond issue, judicially exercised by the application of the absolute rule in *Magruder v. Drury,* 235 U.S. 106, that a fiduciary may not profit by his trust, where there are no findings by the court that the first mortgage leasehold bonds of the insolvent debtor were acquired in contemplation of the proceeding and the committee member was guilty of bad faith conduct in their acquisition or use?

(b) Is the absolute rule of *Magruder v. Drury,* supra, applicable at all in corporate reorganization proceedings to limit-to-cost claims so acquired in the light of this court's recent decision in *Manufacturers Trust Co. v. Becker* (Oct. 1949 Term, Nov. 21, 1949), 94 L. Ed. 99, and *Securities & Exchange Commission v. Chenery,* 318 U.S. 80, adopting the rule of "good faith conduct" in such proceedings?

REASONS RELIED UPON FOR THE ALLOWANCE OF THE WRIT

1. The Court of Appeals, although it referred to Section 212 of Chapter X of the Bankruptcy Act, 11 U.S.C.A. Sec. 612, for the court's power to limit-to-cost claims acquired by fiduciaries in corporate reorganization proceedings, actually based its decision on the rule in *Magruder v. Drury,* 235 U.S. 106, holding that the circumstances of good faith in the acquisition of the claims or in their use were immaterial under that rule. The effect of such decision is to read into Section 212 the word "must" instead of Congress' "may" and to make it mandatory in such proceedings automatically to limit such claims to cost under all circumstances.

It is important to the administration of Chapter X of the Bankruptcy Act to know whether it was the Congressional intent under this section to require the Bankruptcy Court to limit-to-cost claims acquired by fiduciaries irrespective of when or how acquired or used in the proceeding, or whether the intent of the Congres was to require the Bankruptcy Court to limit-to-cost only such as are acquired in contemplation or during the proceeding and to use a sound judicial discretion in so limiting. This section has not heretofore been interpreted by this court.

2. The decision of the Court of Appeals is based on the application of the rule in the case of *Magruder v. Drury,* supra. In that respect it is in direct conflict with the "good faith conduct" rule adopted by this court in the *Chenery case,* 318 U.S. 80, and the very recent case of *Manufacturers Trust Co. v. Becker* (Nov. 21, 1949), 94 L. Ed. 99, in corporate reorganization cases, both of which discuss and deliberately hold the rule in *Magruder v. Drury* inapplicable in such cases.

The decision of the Court of Appeals, being dated seventeen days after the date of the decision of this court in *Manufacturers Trust Co. v. Becker,* supra, if not reversed or considered by this court in an opinion dealing with the question involved, will create great confusion in bankruptcy courts as to whether the rule in *Magruder v. Drury* or in *Manufacturers Trust Co. v. Becker,* applies.

Wherefore, your petitioner prays that a writ of certiorari issue under the seal of this court, directed to the Court of Appeals for the Seventh Circuit, commanding said court to certify and send to this court a full and complete record and of the proceedings of the said Court of Appeals had in the case numbered and entitled on its docket No. 9842, In the Matter of Franklin Building Company, a corporation, Debtor, Lena Simonsen, Appellant, vs. John W. Emmerling Trustee of Franklin Building Company, Appellee, to the end that this cause may be reviewed and determined by this court as provided for by the Statutes of the United States; and that the judgment herein of said Court of Appeals be reversed by the Court, and for such further relief as to this court may seem proper.

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BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

THE OPINION BELOW

The opinion of the United States Court of Appeals for the Seventh Circuit is reported in 178 Federal Reporter (2d) 805. The opinion is also printed in full in the record (R. 203-208).

The opinion of the United States District Court for the Eastern District of Wisconsin is reported in 83 Fed. Supp. 263. The opinion is also printed in full in the record (R. 173 to 180, incl.).

JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C.A. Section 1254.

The United States Court of Appeals for the Seventh Circuit in this case "decided an important question of Federal law which has not been, but should be settled by this court" and "has decided a Federal question in a way probably in conflict with applicable decisions of this court". (Supreme Court Rule 38 (5) (b).)

Judgment was entered in this case by the United States Court of Appeals for the Seventh Circuit on December 8, 1949.

A petition for rehearing was denied on the 16th day of January, 1950.

STATEMENT OF THE CASE

There are no contraverted issues of fact in this case. The pertinent facts, fully stated, appear in the petition in our Summary Statement of the Matter Involved.

The bonds purchased by Simonsen were purchased from brokers, never from individual bondholders, and to prevent them from getting into the wrong hands in order to protect the committee and the bondholders in general (R. 37, 38, 40).

The District Court found that "the bondholders' committee frequently urged the other bondholders to retain their bonds, that they did not solicit the purchase of bonds and made some purchases from brokers, and that some of the committee members undobutedly had in mind that the passage of such bonds into unfriendly hands might result in a change in the program then being carried out by the committee" (R. 177).

The Court of Appeals not only agreed with the District Court in those findings but also found that "the bondholders' committee had taken over a gloomy prospect and in their continued efforts had placed the property in a position where the bondholders might be secured from further loss".

Both the District Court and the Court of Appeals held that irrespective of such good faith conduct on the part of Simonsen, the rule of *Magruder v. Drury,* 235 U.S. 106, that a fiduciary may not profit from his trust was applicable here, and limited the claim as to the $8,000 of bonds acquired by Simonsen to the cost of acquisition.

SPECIFICATION OF ERRORS

The United States Court of Appeals erred:

1. In holding that under Section 212 of Chapter X of the Bankruptcy Act the Bankruptcy Court must automatically limit-to-cost claims acquired by a committee member, no matter when or how acquired, or how used.

2. In holding that a member of a bondholders' committee cannot purchase the mortgage bonds of the insolvent corporation issuing them while the committee was managing the building and business of the debtor under a management agreement.

3. In holding that the rule in *Magruder v. Drury,* 235 U.S. 106, that a fiduciary cannot profit by his trust is applicable and absolute to limit-to-cost claims acquired by fiduciaries in corporate reorganization proceedings under Chapter X.

4. In failing to follow the "good faith conduct" rule in such cases as enunciated by this court in *Manufacturers Trust Co. v. Becker* (October Term, 1949), 94 L. Ed. 99, and *Securities & Exchange Commission v. Chenery,* 318 U.S. 80 (1943).

ARGUMENT

I.

Bankruptcy Court in Applying its Statutory Power of Limitation-to-Cost Must Do So Within the Limits of the Statute, and in the Absence of Findings That Claims Were Acquired Fraudulently and in Contemplation of the Pending Proceeding, or Used in Bad Faith in That Proceeding, it Cannot Limit-to Cost Claims Acquired by Fiduciaries.

The trial court did not find that the claims were acquired in contemplation of the proceeding.

Neither did it find, nor did the Court of Appeals opine, that Simonsen acted covertly or traded on inside knowledge, or that his position as a member of the committee managing the business of the debtor enabled him to purchase the bonds at prices lower than he would otherwise have had to pay, or that his acquisition of the bonds affected his loyalty as a member of the committee or in any way prejudiced the interests of the corporation or other bondholders, or that he acquired his bonds upon better terms than the outside world could have acquired them. On the contrary, both lower courts agreed that the utmost good faith attended his purchase of bonds and the discharge of the committee's duties under the management agreement.

1. Statute involved.

The propriety of the order of limitation-to-cost made by the District Court and affirmed by the Circuit Court of Appeals depends upon an interpretation of *Section 212 of Chapter X of the Bankruptcy Act,* 11 U.S.C.A. Sec. 612, which provides:

> "Section 212. The judge may examine and disregard any provision of a deposit agreement, proxy, power

or warrant of attorney, trust mortgage, trust indenture, or deed of trust, or committee or other authorization, by the terms of which an agent, attorney, indenture trustee, *or committee purports to represent any creditor or stockholder,* may enforce an accounting thereunder, may restrain the exercise of any power which he finds to be unfair or not consistent with public policy *and may limit any claim or stock acquired by such person or committee in contemplation or in the course of the proceeding under this chapter to the actual consideration paid therefor."* (Italics ours.)

The Bankruptcy Court, being a statutory court, in applying its limitation-to-cost doctrine must do so within the power granted to it by this statute.

> *Securities & Exchange Commission v. United States Realty & Improvement Co.,* 310 U.S. 434, 455; 60 S. Ct. 1044, 1052.
>
> *Young v. Higbee Company,* 324 U. S. 204, 214; 65 S. Ct. 594, 599.

It took six years of investigations, many hearings and study by the Congress and those bodies interested in the subject of Bankruptcy to formulate the Chandler Act (Bankruptcy Act of 1938), (Senate Report 1916 on H.R. 8046, 75th Cong. 3rd Sess. 1938). Chapter X thereof is, in itself, as complete a code relating to corporate reorganization as could possibly have been evolved. The procedure is fully outlined, and rights and liabilities of all persons affected are fully defined. Provisions relating to fiduciaries, their responsibilities, liabilities, power limitations and fees, are included.

Prior to enactment of *Section 212 of Chapter X of the Chandler Act,* Section 77(b), 11 U.S.C.A. Sec. 207b

applicable to corporate reorganizations, provided: " * * * The Judge shall scrutinize and may disregard any limitations or provisions of any depositary agreements, trust indentures, * * * *and may limit any claims filed by such committee member or agent, to the actual consideration paid therefor."* (Italics ours.)

Congress in enacting *Section 212 of Chapter X of the Chandler Act,* 11 U.S.C.A. 612, deliberately added to the language contained in Section 77B(b) the words *"in contemplation or in the course of the proceeding under this Chapter."*

This proceeding was started *ten years* after Simonsen acquired the great majority of his bonds, *five years* after he acquired the last of them, and almost *three years* after death removed him from the committee. A prerequisite to limitation-to-cost under Section 212 is that the claims must have been acquired "in contemplation of *the* proceeding under this chapter". No finding satisfying this prerequisite was made nor, indeed, from these facts, could have been made.

But this is not the only requirement prescribed by the Congress. The use of the word "may" before the words "limit any claim" implies not just the power to do so, but the power to do so judicially by the exercise of a sound judicial discretion.

The Congress and its advisers were undoubtedly fully aware of and familiar with the rule of *Magruder v. Drury,* and if it intended an automatic application of an absolute rule of limitation-to-cost it would have used the word "shall" instead of "may" as it did in Section 249 of the same Chapter, 11 U.S.C.A. 649, relating to disallowance of fees to committee members and others purchasing claims or stock without prior or subsequent approval of the Judge.

Moreover, if that was intended, it would have specifically proscribed the purchase of claims of the debtor by fiduciaries. It is nowhere in the Act proscribed.

The failure of the District Court and Court of Appeals to give consideration to all of the evidence and facts indicating good faith conduct on Simonsen's part, the lack of fraud and overreaching in the acquisition or use of the bonds, and the application by them of the absolute rule of *Magruder v. Drury,* supra, indicates an arbitrary discretion not contemplated or sanctioned by the provisions of *Section 212 of Chapter X of the Bankruptcy Act.*

II.

If Bankruptcy Court Can Go Beyond the Power Provided in the Statute and Apply the Equity Rule of Limitation-to-Cost in Such Cases, it Must Follow Rule Laid Down by This Court in Manufacturers Trust Company v. Becker, 94 L.Ed. 99, and Securities & Exchange Commission v. Chenery, 318 U.S. 80.

The Court of Appeals was satisfied from the record "that the Bondholders Committee, including William Simonsen, strove valiantly to convince owners of the bonds that they should retain them, and that in many cases purchased such bonds from brokers to protect themselves and their co-owners for whom they were acting, from the possibility of the bonds getting into unfriendly hands" and that "the Bondholders' Committee had taken over a gloomy prospect and through their continued efforts had placed the property in a position where it was possible that the bondholders might be secured from further loss," but concluded that irrespective of such good faith and

beneficial conduct, the rule of *Magruder v. Drury,* 235 U.S. 106, that a fiduciary cannot profit from his trust was absolute and was applicable to this case, and also held that members of the bondholders' committee were precluded from purchasing leasehold mortgage bonds of the insolvent debtor corporation.

If in spite of limitations on its power to limit-to-cost, as contained in *Section 212,* the Bankruptcy Court may apply the equitable power of limitation-to-cost, then it could do so only within the rule as laid down by this Court in the Becker and Chenery cases.

The facts and issues involved on this appeal were identical to those in *Manufacturers Trust Company v. Becker,* 94 L. Ed. 99.

In the Becker case the Referee found that from early 1942 the market value of debtor's property was insufficient to pay its debts. The debentures on which respondents' claims were acquired at prices varying from 3% to 14% of face value, were bought after the Becker brothers became directors in 1942. Petition under Chapter XI was filed in May, 1946. The debenture holders received 42c on the dollar of principal on the sale of the debtor's property in the proceeding. The respondents' purchases were without overreaching or failure to disclose any material fact to the selling bondholders, and there was no contention that the conduct of the Becker directors or the respondents amounted to bad faith or abuse of fiduciary advantage.

In the case at bar the record is silent as to the value of debtor's property in 1932 when the building was turned over to the committee to be managed, but apparently the assets were then considered as having such value potentialities as made it advantageous to all concerned to enter

into a voluntary plan of management by a bondholders' group, all with the ultimate purpose of returning it to the debtor after the bond issue was caught up with defaulted interest and the default in the payment of real estate taxes was cured. The operation of the real estate of the corporation, apparently its only asset, was continued as a going business, and the rentals were used to pay operating expenses, complete the building, and clear up the tax defaults. The great bulk of Simonsen's bonds ($7,000 of the $8,000 involved) was bought in 1937 and 1938. A $500.00 bond was bought in 1940 and a $500.00 bond in 1942. The petition for reorganization was filed in May, 1947. The debtor's building was sold in this proceeding and the first mortgage leasehold bondholders will likely receive 100% of principal of bonds plus $400.00 per $1,000.00 bond on account of interest. Simonsen's purchases were from brokers on the open market, were made without overreaching or failure to disclose any material fact to selling bondholders, and no *bad faith or abuse of fiduciary advantage was found.*

The agreement between the debtor and the Bondholders' Committee (trustee's Exhibit No. 3) was purely a management agreement of a going venture—the operation of a store and office building. A trustee, separate and apart from the Committee, with power to manage the building, collect the rents, etc., (Paragraph 3), and disburse them in manner specified in the agreement, (Paragraph 7), was set up thereunder. The Committee's powers under such agreement were extremely limited and were no different from those devolving upon the directors of a corporation to manage the affairs of a corporation—were not even as broad. The Committee did not have the legal title to anything belonging to the debtor, or the bondholders. The bonds Simonsen purchased were no part

of any turned over to him as trustee for any cestuis. The property rights in them belonged to the individual bondholders who could do with them as they pleased.

The agreement, unlike the testamentary trust involved in Magruder v. Drury, did not create an express trust. It did not vest the legal title of the trust res in the Bondholders' Committee. Vesting of legal title of the trust res in an essential element in the creation of an express trust.

54 Am. Jur. 43.

The making of this agreement in 1932 indicates that all interested believed that the debtor's business had actual and potential values sufficient to warrant a plan of management looking towards an eventual rehabilitation without resort to judicial action. Such business continued, free from judicial interference, for seventeen years thereafter. From the facts alone that the management over the years completed the building, paid up all tax delinquencies, and that a sale of the building in these reorganization proceedings resulted in a price for the building which will probably secure for leasehold bondholders 100% of the principal of their bonds plus $400.00 per $1,000 bond on account of interest, it fairly appears that as time was running the debtor was becoming more than less a going concern. This ultimate result is more favorable to such conclusion than the result in the Becker case of only 52c on the dollar of principal of bonds was to the conclusion there that although insolvent the Calton-Crescent, Inc., was a going concern.

The first Chenery case, the Becker case, and this case all have one thing in common—the reorganization of a corporation under applicable Federal laws. Any court established standard of fiduciary conduct in the purchase

of securities of an insolvent corporation, the subject of reorganization, therefore, should be the same in all cases.

III.

Bankruptcy Court Should Not Have Disregarded the Provision in the Agreement Under Which the Committee Acted Which Made the Members Liable Only for Actual Bad Faith, and Which Did Not Proscribe Purchase of Bonds by Committee Members.

Paragraph 16 of the bondholders' committee management agreement (Trustee's Exhibit 3) provided:

> "Neither the trustee nor the Committee shall (a) *be under any duty, obligation or liability not affirmatively expressed in this Agreement;* (b) be answerable or liable for the acts or omissions of any officer, employee, agent or attorney appointed and selected with reasonable care (c) be responsible for the acts or omissions of the others; nor (d) be responsible to anyone at anytime for any matter or thing connected with or related to this Agreement *except on account of his act or his own actual bad faith* in the discharge of duties or expressed powers hereunder." (Italics ours.)

It set the standard of duty as well as the limits of the committee members' liabilities. Such limitations are not repugnant to law and are valid.

54 Am. Jur. 239.

This provision is the basis upon which persons were prevailed upon and willing to accept membership on the committee. It expressly provided that "no member of the committee shall be under any duty, obligation or liability *not affirmatively expressed in this agreement*".

There is *no* provision in that agreement which forbade the purchase of bonds by committee members. The only liability is for *"actual bad faith"*. In this it expresses the attitude of this Court in the *Chenery* and the *Becker* cases.

We thus have not only applicable judicial pronouncements that the controlling factor in these cases is the presence or absence of good faith, but a specific, valid and binding agreement of all the parties concerned that the committee member shall not be liable except for "actual bad faith". Having taken on the duties of a committee member upon that basis the court should not apply towards such committee member in his conduct a stricter measure of duty, and disregard facts of good faith, fair dealing, and unquestioned loyalty.

The effect of the opinion of the Court of Appeals is to give a windfall to all of the other bondholders, including those who may have purchased at low prices, who never expected or contemplated such a windfall, and who wanted, and have a right to expect, only their aliquot portion of what the security brings. The idea of allowing such a windfall was so abhorrent to the majority of the Judges of the Second Circuit Court of Appeals in the Becker case that they spared no words in saying so (p. 951):

> *"These circumstances do not seem to a majority of the court to afford adequate reason to limit the appellees' demands to the cost of the bonds and to transfer the balance as a windfall to the other debenture holders."* (Italics ours.)

and this court affirmed that attitude.

The belief of the courts below that irrespective of the good faith conduct of the fiduciary the limitation-to-

cost doctrine in corporate reorganization proceedings is absolute, and must be automatically applied, is clearly erroneous.

The rule of "good faith conduct" as adopted by this court in insolvent debtor cases and by the Circuit Court of Appeals in *In Re Calton-Crescent, Inc.*, supra, is sufficiently elastic to prevent abuses in corporate reorganization proceedings and circumvention by the purchase of such claims by the fiduciary's immediate relatives.

CONCLUSION

We submit that the application of the rule in *Magruder v. Drury*, 235 U.S. 106, in corporate reorganization proceedings to limit-to-cost claims acquired by fiduciaries against insolvent corporations is contrary to the avowed intent of the Congress as plainly stated in the wording of *Section 212 of Chapter X, of the Bankruptcy Act*, and is in direct conflict with the latest pronouncements of this Court in corporate reorganization proceedings; that certiorari be granted and the judgment of the Circuit Court of Appeals for the Seventh Circuit be reversed.

Respectfully submitted,

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REPLY BRIEF OF PETITIONER, LENA SIMONSEN

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REPLY BRIEF OF PETITIONER, LENA SIMONSEN

The trustee attempts to distinguish this case from the Becker case claiming that the debtor here was not a going concern when Simonsen purchased his bonds whereas Calton-Crescent Inc. was such when its bonds were purchased.

We have already dwelt on the similarity in the facts of the two cases (also shown by counsel for the respondents Schroeder in petitions #761 and #762), but because the respective financial conditions of the two corporations involved are stressed as factors making the difference in the cases, we desire to call attention to the entire absence of any finding or opinion comment by the lower courts on the extent of the debtor's insolvency, or any reference to a relationship between extent of insolv-

ency of the debtor and the conduct of the members of the committee. The state or extent of insolvency of the debtor at the time of the purchase of the bonds in question was not a factor in the lower courts' determination that the claim on the bonds was to be limited-to-cost of acquisition. They were influenced by and their decisions were based solely on the rule in Magruder vs. Drury.

Such lower court findings and opinion comment as were made of the conduct of the committee members in their relationship and duties to bondholders stress good faith conduct on their part, and in themselves conclusively negative any suggestion of disloyalty or any belief by those courts that extent of insolvency was a factor in their decisions. The results obtained for the bondholders—a better result than in the Becker case by 3½ to 1—aside from other evidence of their efforts and vigilance in the bondholders' interests, speaks volumes for the committee's sincerity and unaffected loyalty, and makes the case for full allowance of the claim stronger than the Becker case.

This court's opinion in the Becker case sets no rule of thumb, or mathematical formula, as to just at what point of insolvency of a corporation a director must cease buying the securities of his corporation or face an inference of disloyalty. As we read the opinion, the limitation-to-cost doctrine in such cases is to be applied only in the case of bad faith conduct on the part of the fiduciary, that evidence of extent of insolvency at the time of acquisition of the corporation's securities may be evidence of bad faith, but is not, in and of itself, conclusive, and particularly when all other evidence proves the utmost of good faith.

We see in the efforts of the Securities & Exchange Commission here to sustain the decision of the courts below a determination to have at least one Appeals Court opinion to point to in the future as approving its contention, so strenuously insisted on in the first Chenery and the Becker cases, that the rule in Magruder vs. Drury is the proper rule to be applied in corporate reorganization proceedings. If the Appellate Court's decision is permitted to stand, it can and will, in the light of its dating, be used to confuse the courts.

If such good faith conduct and result to bondholders as in the case at bar can be disregarded by the courts, and disloyalty inferred irrespective of them, then we can conceive of no case where it will be proper to allow in full claims of directors or committee members in reorganization proceedings. The decisions of this court in the first Chenery and Becker cases will be rendered meaningless.

The error of the Appellate Court is so patent that we believe the petition should be granted and the judgment be reversed instanter.

Respectfully submitted,

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1949.

No. 740

IN THE MATTER OF
FRANKLIN BUILDING COMPANY,
Debtor.

LENA SIMONSEN,
Petitioner,

vs.

JOHN W. EMMERLING, TRUSTEE OF FRANKLIN BUILDING COMPANY,
Respondent.

BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI

ARGUMENT

(The sections herein correspond to those in the brief in support of the petition.)

I.

This Claim Was Properly Limited Under the Rule Which Prohibits a Fiduciary from Profiting from His Trust.

A. Section 212 Did Not Repeal That Rule.

It is argued in behalf of the petitioner that a bankruptcy court, in limiting claims, "must do so within the power granted to it by" Section 212 of the Bankruptcy

Act (Br. 11), and two decisions of this Court are cited in support of that proposition. Neither of those cases had anything to do with Section 212 or with the limitation of the claim of a fiduciary.

It is then said that in adopting Section 212 Congress intended to narrow the statutory provisions as to the limitation of claims filed in reorganization proceedings. The fact is that the intent of Congress was to broaden the powers of the reorganization court;[1] but in any event there is nowhere in the Act anything to suggest that Congress intended to define all the grounds upon which claims can be limited or to abrogate the power and duty of the bankruptcy court, as a court of equity, to apply established doctrines such as the rule which prohibits a fiduciary from profiting from his trust.[2] On the contrary, in Section 57k (which Section 102 renders applicable in Chapter X proceedings) the court is specifically authorized to reconsider allowed claims and to reallow or re-

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[1] See, *e.g.*, House Report No. 1409, 75th Cong., 1st Sess. (1937), p. 37:

> "The subject of corporate reorganizations has long been a source of trouble in courts of equity. Although the decisions, occasionally supplemented by statutory enactment, had progressively expanded the jurisdiction and powers of equity courts in respect to these reorganizations, such jurisdiction and powers were still far too restricted to afford adequate relief. In practice, four principal difficulties had been manifest: * * * (4) the lack of adequate judicial control over the activities of persons concerned in reorganizations."

See also 6 *Collier on Bankruptcy*, 14th ed., Sec. 9.28, pp. 2920-2922, and Sec. 9.31, p. 2929.

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[2] *Magruder v. Drury*, 235 U.S. 106, 119 (1914):

> "The intention is to provide against any possible selfish interest exercising an influence which can interfere with the faithful discharge of the duty which is owing in a fiduciary capacity."

See also 1 *Restatement, Trusts*, Sec. 170, p. 431, Sec. 206, Comment i, p. 563; 3 Bogert, *Trusts and Trustees*, Sec. 485, pp. 109-111.

ject them "in whole or in part according to the equities of the case." It could hardly be suggested that the rule should be more rigid as to the original consideration of claims than as to their reconsideration.

Furthermore, petitioner's argument that the bankruptcy court cannot act on the basis of equitable rules is directly contrary to decisions of this Court:

> "In the exercise of its equitable jurisdiction the bankruptcy court has the power to sift the circumstances surrounding any claim to see that injustice or unfairness is not done in administration of the bankrupt estate. And its duty so to do is especially clear when the claim seeking allowance accrues to the benefit of an officer, director, or stockholder."[3]

> "This Court has recognized that equity must apply not only the doctrines of unjust enrichment when fiduciaries have yielded to the temptation of self-interest but also a standard of loyalty which will prevent a conflict of interests from arising."[4]

B. Section 212 Authorizes Limitation of This Claim.

It is also argued that this claim could not have been limited under the express provision of Section 212, largely because of the length of time that elapsed between the bond purchases by Mr. Simonsen and the institution of the present proceedings. That contention, of course, raises what is largely a question of fact. It is submitted that the record clearly establishes that William Simonsen, like the other members of the Bondholders Committee, "contemplated" these reorganization proceedings at the times he purchased all of the bonds which are now in dispute.

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[3] *Pepper v. Litton,* 308 U.S. 295, 307 (1939).

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[4] *Manufacturers Trust Company v. Becker,* 338 U.S. 304 (1949).

In this connection it must be borne in mind that there is a distinction between "contemplating" reorganization and believing that the time has arrived to institute reorganization proceedings. It may be conceded that the Bondholders Committee did not consider that the time for reorganization was "ripe" until shortly before the institution of the present proceedings (and the dismissal of the pending proceedings) on May 5, 1947. But reorganization was actually contemplated eleven years before that time.

In his testimony Mr. William A. Schroeder made this distinction very clear (R. 114):

> "Q. Would you be able to say about when you first thought about a reorganization proceeding?
> "A. Oh, well, we thought of it even when time wasn't ripe, John. We thought maybe when we owed 30,000 back taxes yet. We always had in mind because we are worried about somebody coming in and doing—and pushing us to the wall."

The undisputed evidence shows that from 1936 on the members of the Bondholders Committee, including William Simonsen, contemplated reorganizing the company when the time should be "ripe", which meant when "we had enough cash on hand so that we could give a dividend immediately in a reorganization" (R. 112). This appears from the following:

1. Despite the fact that the Bondholders Committee was operating the company's business, all during the years after 1932 the company filed its annual reports with the Wisconsin Secretary of State because "we thought we might later on reorganize and maybe use the company and save that money" (R. 111).

2. At a meeting of bondholders on January 13, 1936, there was talk of foreclosure, receivership, and "a plan to raise a fund to pay outstanding taxes" (Ex. 1, pp. 2-3).

3. On February 4, 1937, debtor filed a petition for reorganization under Section 77B (R. 114); five days later, while that proceeding was pending, William Simonsen made his first purchase of these bonds, at 14% of par (Ex. M). Four months later he made another purchase, this time at 11% of par (Ex. N). Six months after that he made a third purchase at the still lower rate of 9% of par (Ex. L); part of these bonds were resold to another committee member at 20% for a profit of $220.00 (R. 30-31, 33).

4. But the Bondholders Committee felt that the time for reorganization "wasn't really ripe in 1936 and '37" (R. 115).

5. On June 2, 1938 the Bondholders Committee agreed that neither second mortgage bondholders nor stockholders had any more equity in the company (Ex. 1, p. 57).

6. Three months later William Simonsen, knowing that first mortgage bondholders then owned all of the remaining equity in debtor, made another purchase, at 9½% of par (Ex. G).

7. The committee "thought of" reorganization when there were still $30,000 in unpaid back taxes (R. 114); according to the committee's trustee's financial reports, Ex. C, this must have been in or before 1939 or 1940.

8. On May 1, 1940, Mr. Simonsen made his fifth purchase, at 10% of par (Ex. H).

9. At a meeting of the Bondholders Committee on May 21, 1941, "A proposed reorganization of the company under Chapter X was discussed generally without any commitment" (Ex. 1, p. 84).

10. The same subject was discussed at another meeting on July 23, 1941 (Ex. 1, p. 85).

11. On November 20, 1942, Mr. Simonsen made his sixth and last purchase, at just under 15% of par (Ex. J).

It is therefore submitted that Section 212 does not delimit the court's power in respect to claims; that even if it did, the facts bring this case within it; and that accordingly there was no error in the decisions of the lower courts.

II.

The Becker Case Provides Additional Support for the Decision in This Case.

The contention is advanced in part II of petitioner's argument that this Court's recent decision in *Manufacturers Trust Company v. Becker,* 338 U.S. 304 (1949), requires reversal of this case. It is submitted that, on the contrary, that case provides additional support for the decision in this case.

In the Becker case this Court held that, in the typical case of a corporation which was at one time solvent, which has become insolvent but remained a going concern, and the financial condition of which is progressively becoming poorer so that it is becoming less and less a going concern and more and more a prospective subject for judicial relief, the directors of the corporation may profit from the purchase of its securities at a discount (1) while it is solvent, (2) after it becomes insolvent but remains a going concern, and (3) until it becomes so little a going concern and so much a prospective subject for judicial relief that a conflict of interests would be created by permitting the purchases; or until liquidation is imminent; or until the evidence shows that the conflict of interests would be likely to delay liquidation; but not after.

In this case the record establishes that Franklin Building Company never became a going concern; and accordingly all of William Simonsen's bond purchases occurred at times when a conflict of interests necessarily arose.

As a matter of fact, while in the *Becker* case the debtor's condition was gradually *deteriorating* toward the point at which it would become a prospective subject of judicial relief, the debtor in this case was always *below* that point, so far below, in fact, that nearly twenty years were required for its condition to *improve* to where it was ready for reorganization. And while in the *Becker* case it was specifically found that the debtor remained a going concern at all times up to the last debenture purchase, here Franklin Building Company *never became a going concern.*

The fact that the debtor was not even a prospective subject of judicial relief until 1947 was recognized by both its own officers and the members of the Bondholders Committee. As William A. Schroeder, its president and later a committee member, put it, the interested parties had thought about reorganization in 1936 or 1937, but had not considered the time "ripe" until 1947 (R. 115, 112-114). The Bondholders Committee discussed reorganization at its meetings of May 21, 1941 and July 23, 1941 (Ex. 1, pp. 84, 85), but took no action until 1947 (Ex. 1, pp. 149, 153).

The further fact that liquidation was imminent, or at least a constant threat, was of course apparent to the committee when it took over management of the building on September 1, 1932. Liquidation remained a distinct possibility for many years after that, as the minutes of the committee meetings of January 13, 1936 (Ex. 1, pp. 1-3) and February 18, 1938 (Ex. 1, pp. 52-53; Ex. 4) clearly show:

January 13, 1936:

"* * * A. C. Schmidt [Chairman of the Bondholders Committee] advised bondholders that in his opinion, foreclosure proceedings would be advisable as in that way it would be possible on court order to borrow money for the purpose of paying the large sum of accumulated taxes for while the building at the present time is self sustaining, the income is not large enough to retire the accumulated taxes with the annual ten percent interest. This matter was discussed from the floor. Bondholders generally being opposed to foreclosure proceedings. Mr. Arthur Richter discussed the matter from various angles intimating that receivership proceedings might be advisable and stating that if bondholders so desired the trustee under the bond issue, Mr. William F. Reinke would commence receivership and foreclosure proceedings. * * *"

February 18, 1938:

"* * * As reports clearly showed the conditions for a transfer had not as yet been met and while the Committee was reporting progress, there is no doubt that several more years would be required before the financial conditions could be worked out in accordance with the requirements of the Agreement. As a result the Committee would continue in charge under the original agreement and on the suggestion of the Chairman, motion was made and seconded that the Bondholders' Committee, on unanimous consent of all bondholders present, continue to operate in accordance with the Agreement covering the second five year period. This was then put to a vote and carried unanimously. * * * "

But the best evidence of the financial condition and history of Franklin Building Company is in the books and records which were introduced into evidence, including the ledger and journals of William A. Rosenberg, the

Trustee of the Bondholders Committee (Ex. D, E, F), his annual audit reports (Ex. C), and the summaries contained in Exhibits P and Q. From all of these the following history may be reconstructed:

At the time of its organization Franklin Building Company issued $51,000 in common stock in payment for the leasehold upon which the building was later built. That building was commenced in 1929, but construction was stopped in 1930. By that time the cost of the building had exceeded the proceeds of the first mortgage bond issue of $244,400, a second mortgage bond issue in the amount of $52,300 had been sold and even so there were no funds available to complete the building. The testimony indicated that between $50,000 and $100,000 was later expended in finishing construction (R. 39, 153). In addition, unpaid accounts due to contractors and other suppliers and creditors amounted to a total of over $50,000 (Ex. C, Audit Report, September 1, 1932-December 31, 1933).

Franklin Building Company never accomplished the purposes of its organization. It never completed the Marquette Building, never paid the cost of its original capital investment in the building and never became a going concern. It did pay real estate taxes for the year 1930 (which, while the record does not disclose the fact, probably did not include any tax upon the building). But 1931 real estate taxes were not paid until many years later, and the result of their non-payment when due was the first default under the First Mortgage Trust Indenture (Ex. 3).

By the Summer of 1932 it had become apparent that the company would not be able to pay interest due on October 1 of that year on the second mortgage bonds and on November 1 on first mortgage bonds. The result of that

was the formation of the Bondholders Committee in August, and the execution of the Trust Agreement and assignment on August 31, 1932, as previously described.

When the Bondholders Committee took over on September 1, 1932, the condition of the company was even more precarious. There was no money in the bank, rents were tied up by garnishment proceedings and so was the bank account, the ground rent was in default, and the electric power and gas were about to be shut off (R. 39, 137). Thereafter conditions improved somewhat, but no real estate taxes whatever were paid until 1934, and it was not until 1936 that the amount paid on past-due real estate taxes was as much as the amount that accrued and became delinquent during the year (Ex. C, P).

During all this time, of course, bad as the cash position was, the over-all picture was still worse. Interest had been accruing on first mortgage bonds at the rate of $15,892.50 per year from May 1, 1932; and on second mortgage bonds at the rate of $3,661 per year from April 1, 1932. Since the building was constructed upon land in which the company had only a 99-year leasehold interest, depreciation and depletion of the building and the leasehold constituted very real elements of operating cost. These amounted to $5,180.72 and $604.75 per year, respectively, and no provision had been made for them since the acquisition of the leasehold on December 29, 1927 and the cessation of the construction of the building about May 1, 1930. Total accruals were thus $25,338.95 per year, and amounted to more than $35,000 by the end of 1932, in addition to unpaid taxes of nearly $21,000.

The financial history of the debtor can best be summarized by the following tabulation of the net loss from operations, after deduction of accrued interest and deprecia-

tion, adjusted to include as expense only taxes for the respective current years (Ex. C, Q):

Years	Net Loss
1932, Sep. 1 to Dec. 31	$11,500.99
1933	30,872.05
1934	27,689.53
1935	24,235.44
1936	22,373.81
1937	23,875.45
1938	21,148.71
1939	16,197.95
1940	15,786.77
1941	16,337.05
1942	18,156.91
1943	18,739.57
1944	21,348.95
1945	19,292.74
1946	12,449.77
1947, Jan. 1 to May 4	5,320.34

On a cash basis, of course, the situation was also extremely dangerous because of the non-payment of real estate taxes and penalties. The amount of unpaid taxes, penalties, (and loan used for refinancing taxes in 1942), as of the ends of the years from 1932 through 1943, when taxes finally reached a current basis, were as follows (Ex. C):

Year	Unpaid Taxes
1932	$20,984.96
1933	29,235.81
1934	37,269.17
1935	40,999.93

1936	42,413.90
1937	38,984.05
1938	42,545.47
1939	37,033.52
1940	28,509.59
1941	21,456.26
1942	16,834.30
1943	10,483.88

Two conclusions from these facts are inescapable. The first is that Franklin Building Company never became a going concern, and at all times was in a financial condition substantially poorer than that contemplated by the *Becker* case as the dividing line between propriety and impropriety in security purchases.

The second conclusion is that liquidation was imminent, or at least a clear and present danger, at all times until the present reorganization proceedings were commenced in May, 1947. The First Mortgage Trust Indenture was in default for over sixteen years, and foreclosure was possible during all of that time. As a matter of fact, one bondholder did bring action on his bonds, and obtained payment in full of $5,000 worth in 1934 (Ex. P,Q). The only way of averting such actions, and liquidation, would have been by instituting reorganization proceedings; but the company was not in a position to do that until 1947.

So whether this question be approached in terms of the rule of the *Becker* case or of the additional limitation on that rule with respect to the imminence of liquidation, the result is the same. When William Simonsen bought his bonds in the years 1937-1942, for four years before 1937, and for four years after 1942, the company was not (and never had been) a going concern, but was in imminent

danger of liquidation. Therefore, when his bond purchases were made there necessarily arose a substantial conflict of interests, and under the rule of the *Becker* case the standard of loyalty which is applied to fiduciaries requires that he, and his successor, be prevented from profiting from his breach of trust.

Far from demonstrating that the decision of this case was erroneous, the *Becker* case actually provides another authority supporting its correctness.

III.

The Terms of the Trust Agreement Do Not Justify Profits of Bondholders Committee Members.

In Part III of their brief, counsel for the first time advance the argument that the exculpatory provisions of the Trust Agreement creating the Bondholders Committee (Ex. 3) prevent limitation of this claim and require that the fiduciary be allowed to retain the profit accruing from his purchases of the bonds in question.

It is said that such provisions are valid, and 54 *Am. Jur.* 239 is cited in support of that statement. But that authority (Section 301 of the division entitled "Trusts") does not state that such provisions are effective to permit a trustee to retain a profit which has resulted from his breach of trust. On the contrary, it cites in a footnote 1 *Restatement, Trusts,* Section 222(2), page 631, the material portion of which is:

> "A provision in the trust instrument is not effective to relieve the trustee * * * of liability for any profit which the trustee has derived from a breach of trust."

Comment b on the same section states the reason for the rule:

> "No provision in the terms of the trust is effective to relieve the trustee who derives profit from a breach

of trust from liability to the extent of the profit. Such provisions as these are invalid on the ground that it would be contrary to public policy to give effect to them."

The question in this case is whether William Simonsen (or his successor) shall be allowed to retain profits derived from his breaches of trust. The authority cited for the claim that the provisions of paragraph 16 of the Trust Agreement permit him to do so does not in fact support that claim, and on the contrary such provisions are not valid as applied to this question.

CONCLUSION

It is submitted that the petition for certiorari and supporting brief disclose no reason why the decisions of the lower courts as to this claim were erroneous; that in fact those decisions are in accord with the applicable rules of law established by this Court; and that accordingly the petition should be denied.

Dated at Milwaukee, Wisconsin, May 11, 1950.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 740

LENA SIMONSEN, PETITIONER

v.

JOHN W. EMMERLING, TRUSTEE OF FRANKLIN BUILDING COMPANY

No. 761

JOHN W. EMMERLING, TRUSTEE OF FRANKLIN BUILDING COMPANY, PETITIONER

v.

ROBERT W. SCHROEDER

No. 762

JOHN W. EMMERLING, TRUSTEE OF FRANKLIN BUILDING COMPANY, PETITIONER

v.

MOLLIE SCHROEDER AND JUNE KUPTZ

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

PRELIMINARY STATEMENT

The Securities and Exchange Commission, pursuant to Section 208 of the Bankruptcy Act, 11

U.S.C. 608, became a party to the proceeding for the reorganization of Franklin Building Company, debtor, under Chapter X of the Bankruptcy Act. The Commission participated in the consolidated appeals to the court below. That court affirmed the holding of the District Court for the Eastern District of Wisconsin that (1) the claims of the Schroeder family, involved in Nos. 761-762, should be allowed in full, and (2) the claim of Lena Simonsen, involved in No. 740, should be limited to cost. The Commission submits this memorandum in support of the petition in Nos. 761-762, but expresses no opinion as to whether further review is warranted in No. 740.

OPINIONS BELOW

The opinion of the court of appeals (R. 203) is reported at 178 F. 2d 805. The opinion of the district court (R. 173) is reported at 83 F. Supp. 263.

JURISDICTION

The decrees of the court of appeals were entered December 8, 1949 (R. 211, 212). A petition for rehearing by Lena Simonsen was denied January 16, 1950 (R. 213). Jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTIONS PRESENTED

In Nos. 761-762 the question is whether, in a Chapter X proceeding, where a fiduciary is limited to cost on his personal holdings of bonds of a debtor, his wife, son and daughter should be similarly lim-

ited where his and their purchases were equally related to the proceeding and were in effect a family enterprise largely directed by the fiduciary.

In No. 740 the question is whether, in the light of *Manufacturers Trust Company* v. *Becker,* 338 U.S. 304, the particular circumstances warranted the courts below in limiting to cost a claim based on bonds of the debtor purchased by a fiduciary for his personal account. Respondents in Nos. 761-762 may advance contentions raising a similar question.

STATEMENT

The Franklin Building Company, a Wisconsin corporation, was organized in 1927 (R. 2). It erected a five-story business building in Milwaukee upon which it placed a first mortgage to secure its 6½ percent bonds in the principal amount of $250,000 (reduced to 4½ percent in 1931) and a second mortgage to secure its 7½ percent bonds in the principal amount of $60,000 (R. 2-3). In September 1932, the debtor being unable to meet its next interest payments on the mortgages, a bondholders committee of five was formed on behalf of the first mortgage bonds, and the management, control and operation of the Franklin Building was by agreement with the debtor thereupon vested in a trustee chosen by the committee (R. 23-26). There is no dispute that the debtor has been insolvent at all times thereafter.

On February 4, 1937, an involuntary petition for reorganization was filed under Section 77B of the

Bankruptcy Act (R. 114). This petition was dismissed shortly thereafter for want of good faith (R. 114). An involuntary petition under Chapter X was filed in 1943 and was pending until its withdrawal on May 5, 1947. On that date a voluntary petition initiated the instant proceeding (R. 114), in which a plan of reorganization has been confirmed.

The subject of the Trustee's petition (Nos. 761-762) is the treatment accorded below to bonds of Mollie Schroeder in the face amount of $10,000 acquired for $3,780; bonds of June Kuptz in the face amount of $4,500 acquired for $2,270; and bonds of Robert W. Schroeder in the face amount of $10,400, $8,300 of which were acquired for $3,494 and the balance for an unknown amount (R. 205-206). Respondents Mollie Schroeder, June Kuptz and Robert W. Schroeder are the wife, daughter and son, respectively, of William A. Schroeder.

William A. Schroeder was one of the original stockholders and organizers of the debtor corporation and he has served as director and president of the company for substantially all of its history (R. 81-82). He was in active charge of the debtor's affairs until the bondholders committee was formed and took over operation of the property in September 1932 (R. 82). In 1937, he was named as managing agent for the bondholders committee and continued in that capacity until the institution of the

present proceeding (R. 82-83). In November 1944, he also became a member of the bondholders committee. He served in that capacity until May 1947, the month when the present proceeding was instituted (R. 82-83). From July until December of 1947, he served in the present proceeding as additional trustee for the purpose of operating the building (R. 82).

During the period January 1941 through June 1947 William A. Schroeder effected purchases of numerous bonds of the debtor for himself and his family. His purchases included substantially all the bonds forming the basis of the claims of his wife, Mollie Schroeder, and his daughter, June Kuptz, as well as many of those forming the basis of the claim of his son Robert W. Schroeder. The other bonds of these respondents were purchased by the son Robert, who, during a large part of the period, shared offices with his father where they engaged in law practice and the real estate business. Although the testimony as to these respondents is that these bonds were purchased with their own money, William appears to have had complete discretion in making the purchases for his wife[1] and daugh-

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[1] See, *e.g.*, the testimony of William A. Schroeder at R. 100:

Q. Now, taking the bonds that are included in the claim of your wife, Mollie Schroeder, which was filed on September 2, 1947, which includes a total principal amount of first mortgage bonds of $10,000.00, what part did you have in the acquisition of those bonds?

A. Well, I am pretty sure either I or my son bought all the bonds for her, because my wife let me or my son take care of that end of it.

ter.[2] Robert also relied upon his father's superior "business judgment" (R. 68), and when Robert was away in the service he gave his father complete discretion to effect purchases for him.[3] Most of the bonds of Mollie Schroeder and Robert Schroeder and all but one of the bonds of June Kuptz were purchased while William A. Schroeder was both a member of the bondholders committee and its managing agent and during the pendency of the involuntary Chapter X proceeding (Ex. 7-10, 15-21; R. 97-101). The last purchase by June Kuptz occurred one month after the institution of the instant voluntary proceeding and while her father

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[2] See, *e.g.*, the testimony of William A. Schroeder at R. 99:

Q. Did she give you any specific instructions?
A. Sure, she did.
Q. At the price she wanted to buy the bonds?
A. She left that to me.
Q. Or as to the amount she wanted purchased?
A. That is correct.
Q. She left that to you, too?
A. Yes.
Q. Subject, of course, to the amount of money she had?
A. I used my own sense, John.

[3] See, *e.g.*, the testimony of Robert W. Schroeder at R. 67 and 68:

Q. What instructions were included in it with reference to how many bonds should be bought, from whom they should be bought, the price to be paid, and so on?
A. The best answer would be as to how many—how much money I had in the safe; the entire amount.
Q. Authorized to spend the entire amount in the safe to buy bonds for you?
A. That is correct.

* * * * *

Q. I appreciate that. Now, at what price was he to buy them?
A. Whatever the market price might have been * * *.

served as additional trustee in the proceeding. June Kuptz lived with her parents during most of the period in which her bonds were purchased (R. 100).

By order of the district court, William A. Schroeder's participation was limited to cost in respect of the bonds purchased in his own name (R. 177), and no appeal was taken from that determination. The district court, however, refused to limit participation on bonds acquired by the Schroeder family (R. 181-182), and this holding was affirmed by a divided court (R. 208).

Petitioner Lena Simonsen (No. 740) inherited $8,000 of the debtor's first mortgage bonds from her husband, William A. Simonsen (R. 47). He had served as a member of the bondholders committee from 1935 until his death in November 1944 (R. 29). From February 1937 to November 1942 he purchased $8,000 face amount bonds for $871.71, the first of these purchases occurring during the pendency of the involuntary Section 77B petition (R. 146-147). The district court limited the participation of Lena Simonsen on those bonds to the $871.71 paid for them by her husband, and this holding was unanimously affirmed.

ARGUMENT

The question raised by the trustee's petition in Nos. 761-762, the *Schroeder* case, is of substantial importance in the administration of Chapter X and has not been ruled upon by this Court. Irrespective

of where the line is to be drawn as to when purchases by a fiduciary are sufficiently related to the proceeding to warrant limitation to cost, avoidance of lax fiduciary standards is so vital to the entire administration of the statute as to warrant review of the holding below that in effect a fiduciary prohibited from profiting through purchases for his personal account may circumvent the policy of the statute by purchases for the account of his family. In *Manufacturers Trust Company* v. *Becker*, 338 U. S. 304, 314, certiorari was granted to review a similar question, but the Court found it unnecessary to reach that question.

The majority decision below sustaining full participation on the claims of the Schroeder family is in conflict with principles which have been applied in other circuits[4] and, as we show below (pp. 12-13), tends to encourage lax fiduciary standards inconsistent with equitable principles and with the basic purpose of the Act. A major objective of reforms in reorganization practice embodied in the Chandler Act was to prevent abuses whereby "the financial well-being of investors and the public" was "sacrificed to the insiders' desires for protec-

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[4] The cases cited in note 7, *infra*, indicate that similar questions have been recurrent in the lower courts, where they generally have been decided contrary to the decision below. At the present time questions of this nature are involved in other Chapter X reorganizations to which this Commission is a party: *In re Pittsburgh Terminal Coal Corporation*, No. 20716 (W.D. Pa.); *In re Chicago Railways Co.*, No. 63984 (N.D. Ill. E.D.).

tion and for further profit."[5] In our view, fulfilment of this objective requires that participation in a bankruptcy proceeding on claims of members of the immediate family of a fiduciary who entered into transactions in the debtor's securities with the knowledge and assistance of the fiduciary should be subject to the limitations applicable to the claims of the fiduciary himself.

1. In limiting to cost the claim on the bonds acquired by Simonsen while serving as a member of the bondholders committee, the court below cited Section 212 of the Bankruptcy Act which expressly authorizes the judge to "limit any claim or stock acquired by . . . [a] committee in contemplation or in the course of the proceeding under this chapter to the actual consideration paid therefor," and applied the rule that "a trustee can make no profit out of his trust" (R. 206). Similar considerations had been expressed by the district court in limiting to cost the Simonsen claim, as well as the claim of William A. Schroeder who did not appeal from that determination.

It is implicit in the decision of the court below (see *infra,* p. 14) that had William A. Schroeder purchased the bonds held by his wife and children for himself rather than for them, participation thereon would have been limited to cost. The majority of the court below held, however, that the im-

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[5] H. Rep. No. 1409, 75th Cong., 1st Sess., p. 37 (1937).

mediate family of William A. Schroeder stand in a different position, since these claimants were not themselves fiduciaries of the bondholders nor acting for a fiduciary, and since their bonds were purchased in their own names and with their own funds. It apparently found irrelevant the facts emphasized in the dissenting opinion (R. 209) that the bond purchases by the Schroeders were a "family enterprise directed by William [A. Schroeder]", who had complete discretion to make purchases for his family and whose own claim had been limited to cost. We agree with the rulings below that Section 212 and applicable equitable principles warrant limiting to cost claims based upon securities acquired by fiduciaries under the circumstances involved in both petitions, but disagree with the failure to limit the claims based upon William A. Schroeder's purchases for the account of his family.[6]

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[6] How fortuitous it was that particular purchases were made for one of the respondents rather than for William A. Schroeder is made clear by his own testimony:

"Q. How did you decide that those particular bonds would be purchased for your daughter?

"A. Because she had some money and we put it—we bought them for her account" (R. 98-99).

* * * * *

"I don't think I hardly had any money, except my wife had some money, so we took her money and bought it" (R. 103).

* * * * *

"Q. When a bond was offered for sale by, say, Toennessen to you or your son, how was it decided whether that bond would be purchased for your wife, your daughter, your son, or yourself?

"A. We had no rule. I couldn't tell you why we did certain things.

Although this Court in the *Becker* case specifically left open the question whether the claims of the wife and mother of a director should be treated the same as claims of a director, the opinion recognizes that circumstances similar to those relied on in the dissenting opinion below are relevant in dealing with questions of this kind. In connection with its holding that the claim of one Fribourg, a business associate of two of the directors, should be allowed in full, this Court stated that "neither director had any indirect interest in Fribourg's holdings or served as his agent for purchase," that Fribourg's purchases began before these directors were elected, and that "there is nothing in the record to indicate that Fribourg's purchases after the Beckers became directors were influenced by advice from them" (338 U. S. at page 314). In the present case William A. Schroeder would seem to have at least an "indirect interest" in the bonds acquired by his family. Moreover, during his tenure as managing agent and member of the bondholders committee, he served as agent for his family in making most of the purchases, and not only gave

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"Q. What would it depend upon?

"A. It didn't depend upon really particularly anything. We tried to divide them up among the family. . . .

"Q. Then, in part, the decision would depend on who had some free cash?

"A. I mean, maybe, who had too much cash. I think maybe that is the best answer. If, maybe, she had more cash than we thought was necessary, maybe then she used them or Bob used them. As I got slowly on my feet I started buying, too." (R. 112.)

advice and assistance but generally exercised his own discretion in purchasing bonds for them.

The holding below as to the Schroeder family will tend to encourage conflicts of interests by fiduciaries and to open new avenues of evasion of equitable limitations applicable to fiduciaries. In laying down the general rule that limitations applicable to the fiduciary do not apply to his immediate family except upon proof that the relative was acting as a "mere front" for the fiduciary (R. 208), the decision would make relationship immaterial. The importance of relationship, particularly that of a spouse, to a fiduciary has long been recognized by the courts in determining the applicability of equitable sanctions.[7] Although under the decision below the fiduciary may not directly increase his own estate through purchases of the debtor's securities, he is permitted to further the interests of his wife and children and thus receive an economic benefit which may well be the practical equivalent of an increase in his own estate. Thus the fiduciary is permitted to accomplish by indirection what he is forbidden to do directly.[8]

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[7] See *In re Midland United Company*, 159 F. 2d 340, 347 (C.A. 3); *In re Midland United Co.*, 64 F. Supp. 399, 416-417 (D. Del.); see also *Holman* v. *Ryon*, 56 F. 2d 307, 311 (C.A. D.C.); *In re Inland Gas Corp.*, 73 F. Supp. 785 (E.D. Ky.); *In re Fulton's Will*, 253 App. Div. 494, 2 N.Y.S. 2d 917; *Gunther* v. *Gove*, 275 Mass. 235, 175 N.E. 464 (1931); *cf. In re Los Angeles Lumber Products Co.*, 37 F. Supp. 708 (S.D. Calif.).

[8] The difficulties of proof illustrated by the instant case makes unworkable as well as unsound the test of whether the fiduciary may have used a member of his family as a "mere front." Here there were no bank records to be examined since,

To permit the immediate family of a fiduciary to utilize his special information and advice, and indeed his personal services and discretion in effecting purchase transactions, thwarts the purpose of the limitation-to-cost rule to foster undivided loyalty of fiduciaries. With respect to the security holders who sell, any unfairness which might result from a purchase by the fiduciary himself is, of course, equally present when the fiduciary's inside information is used on behalf of another purchaser. More important from the standpoint of the estate is the danger that the fiduciary's personal interest in promoting such a purchase program will influence, whether consciously or not, the day-to-day decisions required in the performance of his fiduciary obligations. The public policy against creation of such conflicting interests, which is at the root of the rule limiting the fiduciary's own claim to cost, seems to us equally applicable where he has acted in furtherance of a purchase program for the account of close relatives.

2. The decision below, insofar as it limited to cost a claim based on purchases by a fiduciary for his own account, is challenged by the Simonsen petition in the light of *Manufacturers Trust Co.* v. *Becker,* 338 U. S. 304, and the Schroeder respond-

according to the Schroeders, the funds used in purchasing the bonds in question were to a substantial extent cash which had been kept in a safe in the office shared by William A. Schroeder and his son Robert, and there was nothing to disprove or corroborate their testimony as to whose money was used (R. 92, 99).

ents may also rely on that decision as furnishing support for the ruling below on grounds which the court below itself rejected. The *Becker* case held, under Chapter XI of the Bankruptcy Act, that claims of fiduciaries, acquired when the debtor was only "technically insolvent" and was, according to the District Court's finding, a "going concern", were not required to be limited to cost (338 U. S. at pp. 308, 312). There, this Court indicated, entirely apart from Section 212 which does not in terms apply to Chapter XI, that there is a point prior to the actual institution of proceedings where the lower federal courts are agreed that insiders' purchases of claims against the debtor should be limited to cost because the debtor is a "prospective subject of judicial relief" (338 U. S. at pp. 313-314).

Unlike the situation in the *Becker* case, in the instant case reorganization proceedings for the debtor were actually pending or imminent throughout the period the purchases in question were made. Simonsen's first purchase while a member of the bondholders committee was made during the pendency of an abortive Section 77B proceeding and the bulk of the purchases by William A. Schroeder and his family occurred during the pendency of the involuntary Chapter X proceeding which immediately preceded the instant proceeding.[9] More-

[9] Indeed, Mollie Schroeder's last purchase was made about a week before (Ex. 16-21), and June Kuptz' last purchase was made a month subsequent to institution of the present proceeding (see, *supra*, p. 6).

over, in the *Becker* case the directors to whom the claimants were related had been outsiders who succeeded in preventing the sale of the property at a very low price by arranging for advances by the claimants of substantial sums of new money to the debtor. In the instant case Simonsen had been a member of the bondholders committee which, through its trustee, managed and operated the debtor's property for some time prior to the purchases in question and William A. Schroeder had been one of the original organizers of the corporation and at all times closely associated with its management. Neither Simonsen nor the Schroeders put fresh money into the corporation but concentrated their entire new investment in the purchase of outstanding claims against the debtor.

Accordingly, we believe the holding below with respect to the Simonsen claim is correct and on its facts consistent with the *Becker* case, and that any attempt of respondents in Nos. 761-762 to support the decision below as to them upon similar grounds would be clearly lacking in merit.

CONCLUSION

The decision below with respect to the Schroeder family is inconsistent with equitable principles and with the spirit and purpose of the Bankruptcy Act as interpreted and applied by other courts of appeals; it raises issues of substantial and recurrent importance in the field of bankruptcy and corporate reorganizations. The trustee's petition

for certiorari in Nos. 761-762 should be granted. The holding below as to Simonsen, challenged by the petition in No. 740, is correct on its facts and is not in conflict with *Manufacturers Trust Company* v. *Becker,* 338 U. S. 304. We express no opinion as to whether, in view of its relation to the questions presented in Nos. 761-762, the petition in No. 740 should be granted.

Respectfully submitted,

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MAY, 1950.

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APR 17 19
CHARLES ELMORE

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1949.

No. 761- 762

IN THE MATTER OF
FRANKLIN BUILDING COMPANY,
Debtor.

JOHN W. EMMERLING, TRUSTEE OF FRANKLIN BUILDING COMPANY,
Petitioner,

vs.

ROBERT W. SCHROEDER,
Respondent.

JOHN W. EMMERLING, TRUSTEE OF FRANKLIN BUILDING COMPANY,
Petitioner,

vs.

MOLLIE SCHROEDER AND JUNE KUPTZ,
Respondents.

PETITION FOR WRITS OF CERTIORARI AND SUPPORTING BRIEF

JOHN W. EMMERLING, *Trustee of* FRANKLIN BUILDING COMPANY
633 North Water Street
Milwaukee 2, Wisconsin,
Petitioner, pro se.

JACKSON M. BRUCE,
Of Counsel.

HAMMERSMITH-KORTMEYER CO. MILWAUKEE

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1949.

No.

IN THE MATTER OF

FRANKLIN BUILDING COMPANY,

Debtor.

JOHN W. EMMERLING, TRUSTEE OF FRANKLIN BUILDING COMPANY,

Petitioner,

vs.

ROBERT W. SCHROEDER,

Respondent.

JOHN W. EMMERLING, TRUSTEE OF FRANKLIN BUILDING COMPANY,

Petitioner,

vs.

MOLLIE SCHROEDER AND JUNE KUPTZ,

Respondents.

PETITION FOR WRITS OF CERTIORARI

To the Honorable, the Justices of the Supreme Court of the United States:

The petition of John W. Emmerling, Trustee of Franklin Building Company, for writs of certiorari to the Court of Appeals for the Seventh Circuit in the above-

entitled causes, respectfully shows to this Court as follows:

SUMMARY STATEMENT OF THE MATTER INVOLVED[1]

This petition involves the claims of Mollie Schroeder, Robert Schroeder, and June Kuptz, who are respectively the wife, son, and daughter of William Schroeder, upon first mortgage bonds issued by Franklin Building Company, debtor. Objections to these claims were filed in the proceedings for the reorganization of debtor under Chapter X of the Bankruptcy Act by the trustee appointed in those proceedings, who is the petitioner herein. The objections to these claims were overruled by the District Court, and they were allowed in full, although William Schroeder's claim on his own bonds was limited to cost. There was no appeal as to his claim, but the determination as to these claims was affirmed upon appeal to the Court of Appeals for the Seventh Circuit.

The evidence in the hearing under the Sections 21(a) and 167 of the Bankruptcy Act prior to the objections and in the hearing on the objections established that William Schroeder purchased all or virtually all of the bonds included in these claims for the respective claimants, but the funds used belonged to the latter. It is this petitioner's contention that the evidence further established that the bonds were purchased pursuant to a joint enterprise participated in by William Schroeder and his family, or at least were purchased by him as their agent acting under broad express authority given to him by them. It appeared without dispute that at the time all of the

[1] A more detailed discussion of the evidence, together with citations to the Record, appears in the Statement of the Case in the annexed supporting brief, and is incorporated herein.

bonds were purchased William Schroeder owned one-third of debtor's outstanding stock, was president and a director of debtor corporation, and was the agent in charge of the operation of its entire business. After November, 1944, during the time when some 85% of these bonds were purchased, William Schroeder was also a member of the Bondholders Committee which had been created in 1932 and which had taken over and operated all of the assets and business of the debtor until the appointment of the trustee in the present proceedings in July, 1947. The bonds that were purchased while Mr. Schroeder was a member of the Bondholders Committee were also purchased during the pendency of involuntary Chapter X proceedings, in which the Committee was continued in possession, which were dismissed on stipulation on the same day that the present voluntary proceedings were filed on petition of the debtor.

The bonds owned by these claimants were purchased during the years 1941 to 1947 at prices ranging from 9% to 60% of the face amount. Mollie Schroeder owns $10,000 in face amount bought at a total cost of $3,780.00; Robert Schroeder, $8,300 bought for $3,494.00 and $2,100 as to which he has no records or recollection; June Kuptz, $4,500 bought at a cost of $2,270.00. Distribution in the reorganization proceedings will be 100% of the principal principal of first mortgage bonds plus at least 40% on account of accrued interest. Potential profits to these claimants are thus $10,220.00 to Mollie Schroeder; $10,181.90 to Robert (assuming the bonds as to which he has no information cost the same, on the average, as his other bonds), and $4,030.00 to June Kuptz, a total of $24,431.90.

STATEMENT AS TO JURISDICTION

Jurisdiction of this Court to review this case is based upon Section 1254 of the Judicial Code as amended (28 U.S.C.A., Sec. 1254).

QUESTION PRESENTED

The only question presented is whether the claims of Mollie Schroeder, Robert Schroeder, and June Kuptz should be limited to the cost of their bonds.

REASONS RELIED ON FOR ALLOWANCE OF WRITS

1. The Court of Appeals has in this case decided (in the negative) an important question of federal law which has not been, but should be, settled by this Court, namely: Should the claims of close relatives of a fiduciary who purchased their bonds for them, (a) pursuant to a joint enterprise in which he and they participated; or (b) as their agent acting under broad express authority, be limited to the cost of the bonds?

2. The Court of Appeals for the Seventh Circuit has in this case rendered a decision in conflict with the decisions of the Courts of Appeals for the Second Circuit in *Irving Trust Co. v. Deutsch,* 73 F. (2d) 121 (1934), cert. den. sub nom. *Bell v. Irving Trust Company,* 294 U.S. 709, and for the Sixth Circuit in *In re Van Sweringen Co.,* 119 F. (2d) 231 (1941), cert. den. sub nom. *Terminal & Shaker Heights Realty Co. v. Van Sweringen Co.,* 314 U.S. 671.

In both of those cases it was held that a person who knowingly joins with a fiduciary in his breaches of trust is accountable for any resulting profits. Here it is un-

disputed that William Schroeder was a fiduciary; these claimants joined with him in the purchase of their bonds; yet the Court of Appeals allowed them their full profits.

3. The Court of Appeals for the Seventh Circuit has in this case rendered a decision in conflict with the decision of the Court of Appeals for the Third Circuit in *In re Midland United Co.*, 159 F. (2d) 340 (1947).

In that case it was held that Section 249 of the Bankruptcy Act prohibits the allowance of compensation to a fiduciary whose wife traded in the debtor's securities. The purpose of Section 212 is the same as the purpose of Section 249; it is undisputed that William Schroeder's family traded in debtor's bonds; yet the Court of Appeals refused to limit their claims under Section 212.

Wherefore, your petitioner respectfully prays that Writs of Certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Court of Appeals for the Seventh Circuit, commanding that Court to certify and send to this Court, on a day certain to be therein designated, a full and complete transcript of the record and all proceedings in these cases, which were entitled in that Court: *"In the Matter of Franklin Building Company, a Corporation, Debtor:* Cause No. 9843, *John W. Emmerling, Trustee of Franklin Building Company, Appellant, vs. Robert W. Schroeder, Claimant-Appellee;* and Cause No. 9844, *John W. Emmerling, Trustee of Franklin Building Company, Appellant, vs. Mollie Schroeder and June Kuptz, Claimants-Appellees",* Appeals from the District Court of the United States for the Eastern District of Wisconsin, to the end that said causes may be reviewed and determined by this Court as provided by law; and that your petitioner may have such other and further relief or remedy in the

premises as to this Court may seem just and appropriate; and that the said judgments of the Court of Appeals may be reversed by this Honorable Court.

JOHN W. EMMERLING, *Trustee of*
FRANKLIN BUILDING COMPANY,
Petitioner, pro se.

JACKSON M. BRUCE,
Of Counsel.

IN THE

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MOLLIE SCHROEDER AND JUNE KUPTZ,

Respondents.

BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI

THE OPINIONS IN THE COURT BELOW

The majority and dissenting opinions in the court below are reported at 178 F. (2d) 805 and at R. 203-209.

STATEMENT AS TO JURISDICTION

Jurisdiction of this Court to review this case is based upon Section 1254 of the Judicial Code as amended (28 U.S.C.A., Sec. 1254).

STATEMENT OF THE CASE

These matters arise out of proceedings in the United States District Court for the Eastern District of Wisconsin for the reorganization of Franklin Building Company, a Wisconsin corporation, debtor, under Chapter X of the Bankruptcy Act. The petitioner herein, who was appointed trustee in the reorganization proceedings on July 9, 1947, filed objections to the claims of eight persons (including these respondents—R. 122-130) on first mortgage bonds issued by debtor, and asked that the District Court limit their claims to the actual cost of their bonds. After hearing the court filed its written opinion (R. 173-180), in which it directed the limitation of the claims of four of the claimants, including William Schroeder, the husband of Mollie Schroeder and father of Robert Schroeder and June Kuptz (R. 52, 97, 106). However, the court directed that the claims of Mollie Schroeder, Robert Schroeder, and June Kuptz be allowed in full. Pursuant to the opinion, orders were entered allowing in full the claims of Mollie Schroeder and June Kuptz (R. 181) and the claim of Robert Schroeder (R. 182). These orders were appealed by the petitioner-trustee on the same record (R. 188-191); they were affirmed by the decision of the Court of Appeals for the Seventh Circuit.

Franklin Building Company was organized as a Wisconsin corporation in 1927 (R. 2). William Schroeder was one of the organizers, and has at all times owned

one-third of the $51,000 in common stock which was issued by the company. He was also a director of the company and its president for substantially all of its history (R. 81-82). The company commenced erection of an office building in the City of Milwaukee in 1929, but construction ceased in 1930 before the building was completed (R. 39, 153).[2] To finance the building it executed a first mortgage securing 6½% bonds in the amount of $250,000, all of which were issued, and a second mortgage to secure 7½% bonds in the amount of $60,000, of which $52,300 were sold (R. 174). Before the building was completed the company ran out of funds, and in later years between $50,000 and $100,000 was expended to finish construction (Exs. C, D, E, F, P, Q; R. 2-3, 39, 153).

At the time that construction of the building was halted, unpaid accounts due to contractors and other suppliers and creditors amounted to more than $50,000 (Ex. C). Real estate taxes for the year 1930 had been paid, but 1931 real estate taxes were not paid until many years later (Ex. C, P, Q), and the non-payment of these taxes when due was the first default under the first mortgage trust indenture (Ex. 3). By the summer of 1932, payments upon the 99-year ground lease of the land upon which the building was constructed were in default and it was apparent that the company would be unable to pay the interest coupons on first mortgage bonds which would come due on November 1, 1932 (R. 23, 137).

The result of the precarious condition of the company in the summer of 1932 was a meeting of bondholders in August of that year, at which a Bondholders Committee

[2] The completed portions of the building were offered for rent to tenants, but there is no evidence in the Record as to occupancy or income before September 1, 1932.

was formed (R. 23). On August 31, 1932, the debtor corporation executed to the Bondholders Committee's trustee an assignment of all of its past-due and future rental and other income (Ex. 3, par. 6; R. 24). On the same date a Trust Agreement was entered into by the debtor and the committee (Ex. 3; R. 25, 151); its material provisions are summarized in the margin.[3] In addition, powers of attorney, of which Exhibit 4 is typical, were obtained from a large percentage of the bond-

[3] The Trust Agreement provided:

1. The entire management and control and operation of the company's property was vested in a trustee to be chosen by the Bondholders Committee; and the trustee was made subject to removal by the committee and all his acts were made subject to its approval (Par. 1).

2. The Trust Agreement provided that it should remain in effect for a period of five years and should be continued for an additional period of five years unless all taxes, ground rent, and interest on the bonds of the company should have been paid for one year at the rate of 5% per annum. It provided that the committee should hold office for the same period and that vacancies should be filled by the committee unless the holders of 10% in amount of the outstanding bonds should demand that the selection of a successor be made directly by the bondholders (Par. 2).

3. The duties and powers of the trustee included management of the building and collecting rents and income; paying operating expenses; employing help; paying taxes, ground rent, repairs, interest, and other expenses; bringing actions to collect money due to the company; appointing and compensating a rental agent; and preparing complete and comprehensive annual financial reports of the income and expenses of the building and all money collected or paid out and delivering copies thereof to the parties to the Trust Agreement (Par. 3).

4. Franklin Building Company assigned all past due and future rents and other income to the Trustee (Par. 6).

5. The income derived from the operation of the building and all other money coming into the hands of the Trustee was to be expended as follows: (a) For the necessary operating expenses of the building; (b) For the payment of taxes; (c) For the payment of ground rent; (d) For the payment of interest; (e) For the payment of claims of unsecured creditors; (f) For the purchase of First Mortgage Bonds as provided in Paragraph 11 (Par. 7).

6. No interest was to be paid on bonds unless the net income of the building, after payment of operating expenses, taxes, and ground rent, should be sufficient to pay interest, and then only at the discretion of the Bondholders Committee, with certain maximum rates provided; or, in-

holders; these authorized the execution of the trust agreement (R. 26).

On September 1, 1932, the Bondholders Committee took over all of the assets and business of debtor pursuant to the Trust Agreement and commenced operation of debtor's building and business; it continued such operation in the same manner until the appointment of the trustee in the reorganization proceedings on July 9, 1947 (R. 26, 34).[4] When the committee took over, there was no money in the bank, all rents were tied up by garnishment proceedings, as was the bank account, and the electric power and gas were about to be shut off (R. 39, 137). In addition, real estate taxes and payments on the ground lease were in default, there were no funds available for payment of interest on either of the bond issues, and the amount due on construction of the building was still over $50,000 (Ex. 3, C; R. 39, 137).

During the years from 1932 through 1947, operation of the debtor's business resulted in a net loss during each year; the losses varied between $10,000 and $30,000 on

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stead of paying interest, the committee was authorized to redeem First Mortgage Bonds (Par. 8).

7. "If and when the said Committee shall have money on hand after the payment of cost of operation of said building, and all taxes and ground rent, and such interest as they shall have decided to pay to the first and second mortgage bondholders, such money shall be used for the purchase and redemption of first mortgage bonds on the open market at the best price obtainable and if bonds cannot be obtained on the open market at less than par then first mortgage bonds shall be redeemed by lot from all outstanding first mortgage bonds." (Par. 11).

[4] By its terms the Trust Agreement remained in force for five years and for an additional five-year period because the conditions for its termination had not been met in the first five years. It contained no provision for extension after September 1, 1942, but the committee decided to continue to operate the business, and probably advised the bondholders accordingly. In 1946 and 1947 a ratification of this action was obtained from some of the bondholders (R. 27).

an annual basis (Ex. C, Q).[5] Unpaid real estate taxes and penalties increased to more than $42,000 in 1936, reached a slightly higher figure in 1938, and then were gradually reduced until they were paid currently in 1944 (Ex. C).[6]

[5] The following is a tabulation, taken from the figures in Exhibits C and Q, showing the net loss from operations in each year, after deduction of accrued interest, depreciation on debtor's building, and amortization of the leasehold, but adjusted to include as expenses only the real estate taxes which came due during the respective years:

Years	*Net Loss*
1932, Sept. 1 to Dec. 31	$ 11,500.99
1933	30,872.05
1934	27,689.53
1935	24,235.44
1936	22,373.81
1937	23,875.45
1938	21,148.71
1939	16,197.95
1940	15,786.77
1941	16,337.05
1942	18,156.91
1943	18,739.57
1944	21,348.95
1945	19,292.74
1946	12,449.77
1947, Jan. 1 to May 4	5,320.34

[6] The following is a tabulation, taken from Exhibit C, showing the unpaid balance of taxes, interest and penalties, and loan used for refinancing taxes in 1942, as of the ends of the years 1932 through 1943:

Year	*Unpaid Taxes*
1932	$ 20,984.96
1933	29,235.81
1934	37,269.17
1935	40,999.93
1936	42,413.90
1937	38,984.05
1938	42,545.47
1939	37,033.52
1940	28,509.59
1941	21,456.26
1942	16,834.30
1943	10,483.88

One bondholder brought action on his bonds, and as a result in 1934 he obtained payment in full on $5,000 in face amount (Ex. P, Q). At a meeting of the bondholders on January 13, 1936, there was talk of foreclosure by the trustee under the First Mortgage Trust Indenture, receivership, and a plan to refinance unpaid real estate taxes (Ex. 1, pp. 2-3). On February 4, 1937, debtor filed a voluntary petition for reorganization under Section 77B of the Bankruptcy Act which was dismissed shortly later as not having been filed in good faith (R. 114). Around the middle of 1937 William Schroeder became managing agent of debtor's business under the direction of the trustee for the Bondholders Committee, and he continued as such until the institution of the present proceedings, attending to the day-to-day operation of the building (R. 82). The minutes of the Bondholders Committee (Ex. 1, 2) indicate that thereafter Mr. Schroeder regularly attended its meetings. On June 2, 1938, at a meeting of the Bondholders Committee, Mr. Schroeder and the members of the Committee agreed that neither second mortgage bondholders nor stockholders had any more equity in the company (Ex. 1, p. 57). At a meeting of the Bondholders Committee on May 21, 1941, "A proposed reorganization of the company under Chapter X was discussed generally without any commitment" (Ex. 1, p. 84). The same subject was discussed at another meeting on July 23, 1941 (Ex. 1, p. 85).

On November 30, 1943, a group of creditors instituted involuntary reorganization proceedings under Chapter X (R. 114). The Bondholders Committee was continued in possession, and operation of the debtor's business continued as before under the committee, its trustee, and Mr. Schroeder during the pendency of the proceedings (R.

26-27, 34, 82). The bonds of the creditors who instituted those proceedings were purchased from them on February 25, 1946, as a result of negotiations conducted by William Schroeder over a period of years, but the proceedings remained pending until May 5, 1947, the date upon which the present voluntary petition was filed, when they were dismissed on stipulation (Ex. 9; R. 57, 97, 114-115).[7]

On November 14, 1944 William Schroeder became a member of the Bondholders Committee, and he continued as such until May 14, 1947, when he was replaced by his son Robert (Ex. 2, pp. 157, 159; R. 29, 52, 83).

Neither William Schroeder nor any of these claimants purchased any first mortgage bonds of debtor at the time of the original issue (Ex. O; R. 83-84). All of the bonds purchased and now owned by Mr. Schroeder and his family were bought between January 7, 1941 and June 6, 1947. A complete schedule of the purchases of the Schroeder family is contained in Exhibit O, the essential parts of which are reproduced in the margin.[8] The facts

[7] $2700 in face amount of these bonds were purchased by Robert Schroeder for $1,620.00 (Ex. 9). William Schroeder carried on "most of the negotiations" and did the "bargaining as to price" (R. 56-57). Others of these bonds were bought by a former associate of William Schroeder; as to this transaction, the latter testified, " * * * we even had to sell him and pick up some bonds cheaper for him to level out the price, because he claimed $600.00 was too much * * * " (R. 94).

[8] Exhibit O: Bonds purchased by William Schroeder, Mollie Schroeder, Robert Schroeder, and June Kuptz:

Date Acquired	*Bond No.*	*Face Amount*	*Price*	*For Whom*
1/ 7/41	513	$1,000	$100.	Mollie Schroeder
6/25/42	51	500	45.	" "
	131	100	9.	Robert Schroeder
	170	1,000	90.	Mollie Schroeder
	401	500	45.	" "
	493	1,000	90.	Robert Schroeder
5/24/44	248	100	25.	Mollie Schroeder

Date Acquired	*Bond No.*	*Face Amount*	*Price*	*For Whom*
12/29/44	509	1,000	310.	Robert Schroeder
10/ 2/45	486	1,000	360.	" "
1/10/46	245	100	45.	" "
	402	500	225.	" "
2/18/46	352	500	210.	" "
2/25/46	34	500	300.	" "
	82	100	60.	" "
	133	100	60.	" "
	217	100	60.	" "
	234	100	60.	" "
	239	100	60.	" "
	240	100	60.	Robert Schroeder
	246	100	60.	" "
	253	100	60.	" "
	254	100	60.	" "
	277	100	60.	" "
	297	100	60.	" "
	319	500	300.	" "
	341	500	300.	" "
4/15/46	137	500	215.	" "
5/ 3/46	510	1,000	470.	" "
5/25/46	322	500	225.	June Kuptz
	361	500	225.	" "
6/ 5/46	373	500	225.	Mollie Schroeder
7/17/46	379	500	300.	" "
9/ 3/46	18	1,000	490.	William Schroeder
	49	500	245.	" "
	52	500	245.	" "
10/15/46	516	1,000	500.	Mollie Schroeder
10/30/46	192	1,000	500.	" "
	207	500	250.	" "
11/ 7/46	353	500	240.	" "
	371	500	240.	" "
12/13/46	110	100	50.	" "
	111	100	50.	" "
	267	100	50.	" "
	268	100	50.	" "
12/30/46	169	1,000	500.	" "
1/17/47	418	1,000	500.	William Schroeder
1/22/47	37	1,000	480.	" "
2/10/47	366	500	260.	" "
3/28/47	466	1,000	520.	Mollie Schroeder
	467	1,000	520.	June Kuptz
4/ 7/47	368	500	260.	" "
	465	1,000	520.	" "

as to the bonds now owned by these claimants and by Mr. Schroeder may be summarized as follows:

William Schroeder: In 1946 and 1947 purchased six bonds of a total face amount of $4,500 at a total cost of $2,220, or 49.3% of the face amount; his distributive share, at 140%, had his claim not been limited, would have been $6,300, for a profit of $4,080, or 90.7% of the face amount of his bonds.

Mollie Schroeder: In 1941, 1942, 1944, 1946, and 1947 purchased 18 bonds amounting to $10,000 at a cost of $3,780, or 37.8% of the face amount; her distributive share at 140% would be $14,000, for a profit of $10,200, or 102.2% of the face amount of her bonds.

Robert Schroeder: In 1942, 1944, 1945, and 1946 purchased 23 bonds amounting to $8,300 at a cost of $3,494, or 42.1% of the face amount. He also purchased 4 bonds amounting to $2,100 as to which he has no records or recollection of the cost (R. 57-58, 59, 65); assuming these were also acquired at 42.1% of the face amount, his bonds amount to a total of $10,400 at a total cost of $4,378.10. His distributive share at 140% would be $14,560, for a profit of $10,181.90 or 97.9% of the face amount of his bonds.

June Kuptz: In 1946 and 1947 purchased bonds amounting to $4,500 at a cost of $2,270, or 50.4% of the face amount; her distributive share at 140% would amount to $6,300, for a profit of $4,030.00 or 89.6% of the face amount of her bonds.

Date Acquired	*Bond No.*	*Face Amount*	*Price*	*For Whom*
6/ 6/47	491	1,000	520.	June Kuptz
Unknown	136	500	Unknown	Robert Schroeder
"	266	100	"	" "
"	357	500	"	" "
"	453	1,000	"	" "

The Schroeder Family: In the years 1941 through 1947, purchased 57 bonds with a total face amount of $29,400 at a cost[9] of $12,648.10, or 43.0% of the face amount; their distributive shares at 140% would total $41,160, resulting in a profit to them of $28,511.90, or 97.0% of the face amount of their bonds.

These claimants: Their bonds total $24,900 in face amount and cost $10,428.10,[10] or 41.9%; their distributive shares at 140% would total $34,860.00, for a profit of $24,431.90, or 98.1% of the face amount of their bonds.

SPECIFICATION OF ERRORS

The Court of Appeals erred in the following respects:

1. In holding that the rules of equity as applied in reorganization proceedings do not require the limitation to cost of bonds owned by close relatives of a fiduciary who purchased their bonds for them either (a) pursuant to a joint enterprise in which he and they participated, or (b) as their agent acting under broad express authority.

2. In holding that the participation of such persons in the breaches of trust of the fiduciary does not also require the limitation to cost of their claims.

3. In holding that Section 212 of the Bankruptcy Act does not require the limitation to cost of bonds owned by close relatives of a fiduciary who purchased their bonds for them either (a) pursuant to a joint enterprise in which he and they participated, or (b) as their agent acting under broad express authority.

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[9] Making the same assumption as to Robert's bonds of which he has no records.

[10] Making the same assumption as to Robert's bonds of which he has no records.

4. In affirming the orders of the District Court overruling the objections to these claims and allowing them in full.

ARGUMENT

I.

These Claims Should Be Limited to Cost Because the Claimants Are Close Relatives of a Fiduciary Who Purchased Their Bonds for Them, (A) Pursuant to a Joint Enterprise in Which He and They Participated; or (B) As Their Agent Acting Under Broad Express Authority.

This case involves a question of federal law which has great importance in the administration of the arrangement and corporate reorganization provisions of the Bankruptcy Act. That question is: Should the claims of close relatives of a fiduciary be limited to cost when it appears that the fiduciary purchased their bonds for them, (a) pursuant to a joint enterprise in which he and they participated; or (b) as their agent acting under broad express authority? The Court of Appeals answered the question in the negative and affirmed the order of the District Court allowing the claims in full. The claim of the fiduciary on his own bonds, however, had been limited by the District Court, and there has been no appeal from that determination.

This Court has recently given clear indication that precisely this same question has not been settled by it. In *Manufacturers Trust Company v. Becker,* 338 U.S. 304 (Nov. 21, 1949), there were before the Court the claims of close relatives of two directors of a corporation which had filed its petition for an arrangement under Chapter XI of the Bankruptcy Act. It appeared that the claim-

ants' debentures "were purchased through the agency of" the directors, "and in the latter's judgment." This Court indicated that in analyzing the propriety of the purchases it would "view the claims initially as if they were claims of directors", but held that, even when so viewed, none of the purchases was improper. Accordingly, in a footnote, the decision was specifically limited: "Thus it becomes unnecessary to determine whether the relation of the Becker respondents to the directors was such as to require limitation of these respondents' claims if they would be disallowed in part as claims of directors." In this case it appears without question that these claimants' bonds were purchased "through the agency of" William Schroeder "and in the latter's judgment."[11] It

[11] William Schroeder testified that he participated in the purchase of at least some of the bonds presently owned by Mollie Schroeder, Robert Schroeder, and June Kuptz, his wife, son, and daughter, and included in their claims (R. 96-97), and that either he or his son bought all of his wife's bonds (R. 100). Neither Mollie Schroeder nor June Kuptz appeared as a witness in any of the proceedings, and all of the evidence as to the acquisition of their bonds was presented by William Schroeder. Not only is there no evidence to indicate that Robert Schroeder purchased any of his sister's bonds, or any of his mother's bonds with the possible exception of three that were billed to him and one that was billed to his father-in-law (Ex. 18, 21), but there is no evidence that he acquired any of his own bonds except his testimony that he "thinks" he handled the negotiations on his No. 510 (R. 71). (He at one time also said that he bought his No. 352 (R. 60), but later said that this bond was billed to William A. Schroeder (R. 62-63) and that his father "spoke to" the seller about the purchase (R. 71).) As a matter of fact, the testimony indicates that William A. Schroeder probably purchased all of Robert's bonds for him (R. 57-58, 63, 68-72), that many were purchased while Robert was a student or out of the country (R. 53, 55, 63, 67; Ex. 7, 10), and that as to four bonds Robert has no records of the purchase (R. 57-58, 59, 65).

Robert Schroeder testified that his first bonds were purchased for him while he was a student, and that his father negotiated the purchase (R. 70-71). Later, before he went into military service, he left money with his father, who was "authorized to make purchases for me out of that money", to spend "the entire amount" (R. 67); Robert simply "told him to use his good judgment" (R. 68). After Robert returned it was

is therefore clear that this case presents the same question that was specifically left undetermined in the *Becker* case.

The importance of this question is four-fold. In the first place, as this case now stands it constitutes a sign-post which points out, for the benefit of any fiduciary who seeks it, the road to evasion of his duties to his beneficiaries. If he has learned from his intimate knowledge of his trust that there is a profit to be made in its securities, this case tells him how to reap that profit for the benefit of his family, even though he knows no court would allow him to gain it for himself. Indeed, this case tells him that if he trades in the securities of his trust for his own account, as well as for his family, and decides simply on the basis of "who had too much cash"[12] whether he will purchase a particular bond for himself, for his wife, for his son, or for his daughter; and if subsequently his own claim is limited to the cost of his bonds—even so, his family will be allowed to retain their profits. In

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no longer necessary for him to give William such broad authority because he shared offices with his father and was engaged with him in the practice of law and the real estate business (R. 63-64), and therefore was available for consultation; but there can be no question that his father acted with his authority in making subsequent purchases for him.

William Schroeder testified that his daughter June Kuptz had money on deposit with him, that she told him that "if I could buy some bonds for her it was O.K.", and that she left it to him to determine the price at which the bonds were to be bought and the amount to be purchased (R. 99); at the time when her bonds were purchased, she lived with her father (R. 100). As to his wife Mollie, Mr. Schroeder testified that "either I or my son bought all the bonds for her, because my wife let me or my son take care of that end of it" (R. 100). It subsequently appeared that he negotiated the purchase of all of her bonds with the possible exception of three which were billed to his son Robert and one which was billed to his son's father-in-law (R. 102-106).

[12] When William Schroeder was asked how it was decided whether a given bond "would be purchased for your wife, your daughter, your son, or yourself", he testified that "the best answer" was that the decision would depend upon "who had too much cash" (R. 112).

view of the large number of proceedings under the Bankruptcy Act which may be expected in the future, and the likelihood that many fiduciaries may seek to follow the road pointed out by this case, it is submitted that this Court should settle for once and for all what rule is to govern their conduct.

The importance of the question is equally clear if it is viewed from the standpoint of the relatives of the fiduciary. In the normal course of things they will know of his position, and perhaps also of opportunities for profit which have come to his attention in his representative capacity. Suppose his wife, or his son, or his daughter, having such information and some funds to invest, prevails upon the fiduciary to purchase some bonds for him or her, and the result is a handsome profit. Is the relative who thus induces the fiduciary to be faithless to his trust, and who stands to gain from the knowledge which the fiduciary acquired in a position of trust and confidence, going to be permitted to reap the profit; or should a court of equity recover it for the fiduciary's beneficiaries? Stated that way this question also merits the attention of this Court.

The result is the same if the question is approached solely in terms of the interests of the former owners of bonds purchased by close relatives of a fiduciary. There is not one word of testimony or any other evidence in this record to show that the former owners of these bonds were given any information whatever in connection of the sale of their bonds.[13] On such a record, and in view of the fact that the fiduciary purchased their bonds for these claim-

[13] Copies of a one-page annual report showing income and expenses but not assets or liabilities were sent to bondholders annually until 1943 by the Committee's trustee (R. 160-161); but there is no evidence that any other information was distributed, either generally or to the seller at the time of any sale transaction. The burden of proof as to this would

ants,[14] what equitable considerations favor these claimants? This Court should decide that.

Finally, the question presented is extremely important because, while the law as to facts like those in the case at bar has never been settled by this Court, the decision by the Court of Appeals tends to cast a shadow over fundamental principles laid down by this Court in other cases in which it has recognized the great public interest in all types of bankruptcy proceedings and in all other proceedings in which it is necessary that "the level of conduct of fiduciaries" be "kept at a level higher than that trodden by the crowd", as Justice Cardozo once so eloquently expressed it.[15] The following quotations make this Court's position as to these principles abundantly clear:

> "The intention is to provide against any possible selfish interest exercising an influence which can interfere with the faithful discharge of the duty which is owing in a fiduciary capacity."[16]

> "In the exercise of its equitable jurisdiction the bankruptcy court has the power to sift the circumstances surrounding any claim to see that injustice or unfairness is not done in administration of the bankrupt estate. And its duty so to do is especially clear when the claim seeking allowance accrues to the benefit of an officer, director, or stockholder."[17]

> "It is no answer to say that fraud or unfairness were not shown to have resulted. * * * the incidence of a

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be on the claimants: *Pepper v. Litton,* 308 U.S. 295, 306 (1939); and the burden of proof is of course always upon the trustee to justify the fairness of transactions with his beneficiaries: 1 *Restatement, Trusts,* Sec. 170, p. 431.

[14] See summary of evidence in footnote 11, page 19, *supra.*

[15] *Meinhard v. Salmon,* 249 N.Y. 458, 464, 164 N.E. 545, 62 A.L.R. 1 (1928).

[16] *Magruder v. Drury,* 235 U.S. 106, 119 (1914).

[17] *Pepper v. Litton,* 308 U.S. 295, 307 (1939).

particular conflict of interest can seldom be measured with any degree of certainty. The bankruptcy court need not speculate as to whether the result of the conflict was to delay action where speed was essential, to close the record of past transactions where publicity and investigation were needed, to compromise claims by inattention where vigilant assertion was necessary, or otherwise to dilute the undivided loyalty owed to those whom the claimant purported to represent. Where an actual conflict of interest exists, no more need be shown. * * * "[18]

"This Court has recognized that equity must apply not only the doctrines of unjust enrichment when fiduciaries have yielded to the temptation of self-interest but also a standard of loyalty which will prevent a conflict of interests from arising."[19]

The result in this case manifests no adherence to the principles applied by this Court in those cases. It will be noted that the question which is presented by this case has been stated above in the alternative—should the claims of the fiduciary's close relatives be limited when he purchased their bonds for them either pursuant to a joint enterprise or as their agent? This has been done because, while your petitioner is of the opinion that the evidence clearly establishes that the members of the Schroeder family participated in a joint enterprise, as Judge Kerner specifically held in his dissenting opinion (R. 209),[20] that

[18] *Woods v. City Nat. Bank & Trust Co. of Chicago,* 312 U.S. 262, 268-269 (1941).

[19] *Manufacturers Trust Company v. Becker,* 338 U.S. 304 (1949). To the same effect as these cases, see also: *American United Mutual Life Insurance Co. v. Avon Park,* 311 U.S. 138 (1940).

[20] In addition to the evidence summarized in the Statement of the Case, page 8, *supra,* and in footnotes 11, page 19, and 12, page 20, *supra,* the following facts are material because they clearly show why the joint enterprise was formed: On June 2, 1938, in the light of all the information about debtor which he then had, Mr. Schroeder agreed with the members of the committee that neither second mortgage bondholders

will presumably be disputed by counsel for these claimants. However, it cannot be disputed that William Schroeder acted under broad express authority from these claimants in purchasing their bonds for them;[21] and, since the purchases extended over a period of more than six years, it must necessarily be inferred that they also ratified and approved his doing so. The importance of the question is such that there should be no risk of the denial of this petition because of any doubt about the sufficiency of the evidence to establish a joint enterprise. The question is the same whether there was a joint enterprise or a course of conduct in which Mr. Schroeder acted for these claimants and they received the benefits of his knowledge and position as a fiduciary.

In either situation it is clear that William Schroeder was guilty of breaches of trust when he purchased the

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nor stockholders had any more equity in the company—in effect, that its assets were owned by the first mortgage bondholders (Ex. 1, p. 57). But the time was not then "ripe" for reorganization, although there had been talk about it in 1936 and 1937 (R. 115), and the committee "tried to hold off until we had enough cash on hand so that we could give a dividend immediately in a reorganization" (R. 112); the plan was that this dividend would be at the rate of $10 per $100 of first mortgage bonds (Ex. 2, p. 149).

Thus the facts in Mr. Schroeder's possession in 1941 may be summarized as follows: He knew that Franklin Building Company was going to be reorganized; that after it was, only the holders of first mortgage bonds would have any interest in it; that they would therefore have control of it; and that as a result his only chance to retain a dominant position in the future depended upon his owning or controlling first mortgage bonds. Furthermore, he must have considered that the purchase of bonds would involve little risk because when the reorganization came there would be an immediate 10% dividend, which would exactly repay the cost of the bonds bought in 1941 and more than repay the cost of those acquired in 1942 (Ex. O).

But there was one complication: Mr. Schroeder "had hardly any money" (R. 103). However, this was not an insoluble problem; for his wife had money (R. 103), his son had money (R. 53), and his daughter had money (R. 98-99). That is why the joint enterprise was formed.

[21] See summary of evidence in footnote 11, page 19, *supra*.

bonds now owned by these claimants, just as he was when he purchased his own bonds, as the District Court held. The law governing trustees and other fiduciaries does not merely require them to exclude their own, personal selfish interest: It also prohibits them from acting in the interest of third persons. The trustee "must exclude all selfish interest and also all consideration of the welfare of third persons";[22] he "is under a duty to the beneficiary to administer the trust solely in the interest of the beneficiary";[23] and in reorganization proceedings he must not be allowed "to represent competing classes of creditors or stockholders, or various interests or groups whose purposes and desires are dissimilar", but must be required "to abide by this single standard".[24]

It is not only the fiduciary who is "subject to whatever judicial action may be necessary"[25] if he violates his duty of undivided loyalty to his beneficiaries and the high standard of conduct to which this court has required that

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[22] 3 Bogert, *Trusts and Trustees,* Sec. 543, pp. 375-376.

[23] 1 *Restatement, Trusts,* Sec. 170(1), p. 431.

[24] 6 *Collier on Bankruptcy,* 14th ed., Sec. 9.28, p. 2923.

In addition, in this case bond purchases by William Schroeder after he became a member of the Bondholders Committee constituted breaches of his duty as such to purchase bonds for retirement, for the benefit of all the bondholders. This duty was imposed by Par. 11 of the 1932 Trust Agreement (Ex. 3), which is quoted in footnote 3, page 11, *supra.* Violations of it constituted *additional* breaches of his trust by William Schroeder: 3 Bogert, *Trusts and Trustees,* Sec. 485, pp. 109-111; 1 *Restatement, Trusts,* Sec. 170, Comments j and k, pp. 437-438, and Sec. 206, Comment i, p. 563. There was money available to the Committee to purchase all of the Schroeder bonds bought after March 31, 1946: On that date cash on hand was $8,788.35, and the cash balance increased thereafter (Ex. D, E); the Schroeder bonds bought after that date cost $8,650 (Ex. O), and represent a potential profit of $15,710. Furthermore, even in the absence of funds sufficient to make the purchases for the trust, the trustee is not permitted to buy for himself: *Irving Trust Co. v. Deutsch,* 73 F. (2d) 121, 124 (C.C.A. 2, 1934), cert. den. 294 U.S. 709.

[25] 6 *Collier on Bankruptcy,* 14th ed., Sec. 9.28, p. 2923.

he be held. Those who join with him in his dereliction of duty, even if they otherwise be strangers, are similarly subject to judicial action, and this is particularly true in reorganization proceedings in which "the bankruptcy court has the power to sift the circumstances surrounding any claim to see that injustice or unfairness is not done".[26] Two of the Courts of Appeals have specifically so held with respect to third persons who joined with a fiduciary in seeking improper profits from his trust:

> "It seems soundly settled that one who knowingly joins a fiduciary in purchasing for profit the property of the trust estate in unlawful circumstances becomes jointly and severally liable with him for resultant profits."[27]

> "The theory of the suit is that a fiduciary may make no profit for himself out of a violation of duty to his cestui even though he risk his own funds in the ventures and that anyone who assists in the fiduciary's dereliction is likewise liable to account for the profit so made."[28]

Thus, whether these claimants, the wife, son, and daughter of William Schroeder, be regarded as participants with him in a joint enterprise or as his principals, the result must be the same. In either case they have joined with him in his breaches of his duty, and stand to profit from the influence and the intimate knowledge of debtor's affairs that he gained as such a fiduciary. In either case

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[26] *Pepper v. Litton*, 308 U.S. 295, 307 (1939).

[27] *In re Van Sweringen Company*, 119 F. (2d) 231, 234 (C.C.A. 6, 1941), cert. den. *sub nom. Terminal & Shaker Heights Realty Co. v. Van Sweringen Co.*, 314 U.S. 671.

[28] *Irving Trust Co. v. Deutsch*, 73 F. (2d) 121, 123 (C.C.A. 2, 1934), cert. den. *sub nom. Bell v. Irving Trust Company*, 294 U.S. 709. The District Courts have also enforced this rule: *In re Los Angeles Lumber Products Company, Ltd.*, 46 F. Supp. 77 (S.D. Cal., 1941); *In re Jersey Materials Co.*, 50 F. Supp. 428 (N.J., 1943).

they seek for themselves a gain as a result of transactions which he undertook for them at their request, a gain which rightfully belongs to his beneficiaries and not to his family. In either case this decision of the Court of Appeals points the way in which any fiduciary in any arrangement or reorganization proceeding can evade the principles which this Court has held must govern his conduct and can accomplish by indirection for the benefit of his family what he could not directly accomplish for his own benefit. In either case the decision of the Court of Appeals in this case has cast a shadow over the principles which this Court has held to be governing in similar cases.

It is submitted that it is not only important but vitally necessary that this Court strike down this particular example of the "disintegrating erosion of particular exceptions"[29] to those rules which must govern the conduct of trustees if their beneficiaries are to be given the type of representation which alone can safeguard their interests.

II.

This Decision is in Conflict With the Decisions of the Courts of Appeals for the Second Circuit in Irving Trust Co. v. Deutsch and for the Sixth Circuit in In Re Van Sweringen Co.

It was pointed out in the preceding section of this argument that in purchasing their bonds for these claimants, William Schroeder was guilty of breaches of his duty as a fiduciary;[30] and that under the law as established by the Courts of Appeals for the Second and Sixth Circuits in

[29] *Meinhard v. Salmon,* 249 N.Y. 458, 464, 164 N.E. 545, 62 A.L.R. 1 (1928).

[30] Page 25, *supra,* and authorities cited.

cases in which this Court refused certiorari,[31] these claims must be limited because the claimants joined with him in those breaches of his trust. Since the Court of Appeals for the Seventh Circuit held that these claims should not be limited, its decision in this case is in conflict with the decisions of those two courts and an additional reason is presented for this Court to review the decision in this case.

The participation of these claimants in the breaches of trust of this fiduciary was at least as great as the participation of the third parties in the breaches of trust of the fiduciaries in those cases.

In *Irving Trust Co. v. Deutsch* the facts were that the debtor corporation had hired one Bell to negotiate the purchase for debtor of stock in another company, which he did. When the time for payment came, debtor could not complete the purchase. Instead, debtor's directors and Bell bought the stock for themselves, with their own funds, and later resold it at a substantial profit. Debtor's trustee in bankruptcy sued to compel Bell and the directors to account for their profits, and it was held that all of them, including Bell, must do so. As to Bell the court said:

> "The theory of the suit is that a fiduciary may make no profit for himself out of a violation of duty to his cestui even though he risk his own funds in the ventures and that anyone who assists in the fiduciary's dereliction is likewise liable to account for the profit so made."[32]

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[31] *Irving Trust Co. v. Deutsch,* 73 F. (2d) 121 (C.C.A. 2, 1934), cert. den. *sub nom. Bell v. Irving Trust Company,* 294 U.S. 709; and *In re Van Sweringen Co.,* 119 F. (2d) 231 (1941), cert. den. *sub nom. Terminal & Shaker Heights Realty Co. v. Van Sweringen Co.,* 314 U.S. 671.

[32] 73 F. (2d) at page 123. The court here cites cases, including *Jackson v. Smith,* 254 U.S. 586 (1921), which, while the facts are

not exactly the same as those in the case at bar, is highly important in demonstrating that this Court has given its approval to the general principle applied by the Courts of Appeal in the *Irving Trust Co.* and *Van Sweringen Co.* cases.

In *Jackson v. Smith* it appeared that Ambrose, a court-appointed receiver, had, after the first attempted sale of a note secured by a trust indenture belonging to the debtor, prevailed upon the trustee under the indenture to arrange a second sale in the hope of obtaining a higher bid. Before the second sale it was agreed between Ambrose, Wilson, a stranger to the proceedings, and Smith, attorney for Ambrose, that Wilson would appear at the second sale and use his own judgment as to bidding, and that if he was successful all three would share in ownership of the note. The sale was held, and affirmatively shown to have been a fair public sale. Wilson was the highest bidder, and subsequently voluntarily raised his bid so that the sale would produce enough to clear the land of tax liens. Before taking title, Wilson resold the note at a profit which was divided with Ambrose and Smith. A subsequent receiver brought action against Smith and Wilson only, not Ambrose, to recover the profit made on resale of the note, and it was held that he could recover the entire profit, including that obtained by the receiver Ambrose. The court said:

"When he [Ambrose, the receiver] agreed with Smith and Wilson to join in the purchase if Wilson should become the successful bidder, he placed himself in a position in which his personal interests were, or might be, antagonistic to those of his trust. Michoud v. Girod, 4 How. 503, 552, 11 L.Ed. 1076. It became to his personal interest that the purchase should be made by Wilson for the lowest possible price. The course taken was one which a fiduciary could not legally pursue. Magruder v. Drury, 235 U.S. 106, 119, 120, 35 Sup. Ct. 77, 59 L.Ed. 151. Since he did purchase it and profits resulted the law made him accountable to the trust estate for all the profits obtained by him and those who were associated with him in the matter, although the estate may not have been injured thereby. Magruder v. Drury, 235 U.S. 106, 35 Sup. Ct. 77, 59 L.Ed. 151. And others who knowingly join a fiduciary in such an enterprise likewise become jointly and severally liable with him for such profits. Emery v. Parrott, 107 Mass. 95, 103; Zinc Carbonate Co. v. First National Bank, 103 Wis. 125, 134, 79 N.W. 229, 74 Am. St. Rep. 845; Lomita Land & Water Co. v. Robinson, 154 Cal. 36, 97 Pac. 10, 18 L.R.A. (N.S.) 1106. Wilson and Smith are therefore jointly and severally liable for all profits resulting from the purchase; the former although he had no other relation to the estate; the latter, without regard to the fact that he was also counsel for the receiver. * * * Smith and Wilson are held liable for knowingly confederating with one who, as receiver of the estate of the note holder, owed a duty to it, and who put himself in a position where his personal interest conflicted with his duty." (254 U.S. at pages 588-589).

The court noted that he had been an agent, and that he claimed his agency had terminated, and went on to make it perfectly clear that the decision was based squarely upon his participation with the directors, and that the agency relationship was immaterial:

> "But, even if the fact of his agency be disregarded, we think there is an applicable principle which requires him to account, namely, that one who knowingly joins a fiduciary in an enterprise where the personal interest of the latter is or may be antagonistic to his trust becomes jointly and severally liable with him for the profits of the enterprise."

In *In re Van Sweringen Company* the facts were that the fiduciary directors and two outsiders, Tomlinson and Ball, joined to purchase claims against the debtor at a discount, and did so through a corporation which actually purchased them. Despite the fact that limitation of the corporation's claim would affect Tomlinson and Ball as its stockholders, as well as the fiduciaries, the claim was limited to cost. The court said:

> "It seems soundly settled that one who knowingly joins a fiduciary in purchasing for profit the property of the trust estate in unlawful circumstances becomes jointly and severally liable with him for resultant profits."[33]

[33] 119 F. (2d) at page 234. The *Van Sweringen* case, involving as it does the purchase of claims by a corporation created by the fiduciaries for the purpose, is much like *In re Norcor Mfg. Co.*, 109 F. (2d) 407 (1940), cert. den. 310 U.S. 625, which was decided by the same Court of Appeals that decided this case. In the *Norcor* case the claim involved was purchased by a corporation owned and dominated by the attorney for the managing agent of the debtor. This Court of Appeals held that the claim must be limited to cost, saying:

> "As Krueger occupied a fiduciary relation, so did his attorney Lehner. Neither of them would have been entitled to the allowance of a claim in an amount which would have inured to his individual profit. Being thus precluded as individuals, they had no right to accomplish the same purpose under the guise of a corporate entity." (109 F. (2d) at page 411).

In this case, as the evidence previously summarized[34] establishes, these claimants joined with William Schroeder in the purchase of their bonds. They gave him broad authority to make purchases for him at prices, in amounts, and from persons indicated by his "good judgment".[35] The ultimate owner of the bonds was that person "who had too much cash".[36] What is more, they were his close relatives and thus their profits would inevitably, if indirectly, redound to his benefit; this adds a factor not present in the *Irving Trust* and *Van Sweringen* cases.

It is therefore submitted that the facts in this case bring it squarely within the rules of the cases decided by the Courts of Appeals for the Second and Sixth Circuits, and that the decision in this case accordingly is in conflict with those decisions. This provides a second reason why this Court should review this case.

III.

This Decision is in Conflict With the Decision of the Court of Appeals for the Third Circuit in In Re Midland United Co.

In the preceding sections of this argument these claims have been tested in the light of the principles of equity which are applied in reorganization proceedings independently of the Bankruptcy Act. The point made in this section of the argument is that Section 212 of the Act[37]

[34] Statement of the Case, pages 8 to 17, *supra.*

[35] See evidence summarized in footnote 11, page 19, *supra.*

[36] Testimony of William Schroeder (R. 112).

[37] 11 U.S.C.A., Sec. 612:

"The judge may examine and disregard any provision of a deposit agreement, proxy, power or warrant of attorney, trust mortgage, trust indenture, or deed of trust, or committee or other authorization, by the terms of which an agent, attorney, indenture

also requires limitation of these claims and that the decision of the Court of Appeals in this case in which it refused to limit them is contrary to the decision of the Court of Appeals for the Third Circuit in *In re Midland United Co.*, 159 F. (2d) 340 (1947).

In that case that Court of Appeals affirmed an order of the District Court denying all compensation to the attorney for a protective committee for a senior security. Both the attorney, Harold Evans, and his wife had purchased securities of a subsidiary of the debtor. The decision is based both upon Section 249 of the Bankruptcy Act and upon equitable principles governing the allowance of compensation to fiduciaries. As to Section 249,[38] the court held:

> "Sight must not be lost, however, of the fact that Section 249 not only prohibits trading in 'the stock of, the debtor', but also specifically enjoins allowance of compensation where 'a beneficial interest, direct or indirect, has been acquired or transferred

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trustee, or committee purports to represent any creditor or stockholder, may enforce an accounting thereunder, may restrain the exercise of any power which he finds to be unfair or not consistent with public policy and may limit any claim or stock acquired by such person or committee in contemplation or in the course of the proceeding under this chapter to the actual consideration paid therefor."

[38] 11 U.S.C.A., Sec. 649:

"Any persons seeking compensation for services rendered or reimbursement for costs and expenses incurred in a proceeding under this chapter shall file with the court a statement under oath showing the claims against, or stock of, the debtor, if any, in which a beneficial interest, direct or indirect, has been acquired or transferred by him or for his account, after the commencement of such proceeding. No compensation shall be allowed to any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, or by whom or for whose account such claims or stock have, without the prior consent or subsequent approval of the judge, been otherwise acquired or transferred."

* * *' by any person seeking compensation for services rendered in a reorganization proceeding in *'claims against, or stock of, the debtor.'*

"The facts disclose that there was violation of the latter provision of Section 249 when Mr. Evans bought the preferred stock of NIPSCO and Mrs. Evans bought the preferred stock and bonds of NIPSCO because at the time of these purchases NIPSCO had disputed and undisputed claims against Utilities [the debtor] of some $3,569,000 exclusive of interest. In purchasing these securities of NIPSCO it is obvious that the Evans were indirectly purchasing a beneficial interest in 'claims against * * * the debtor' Utilities." (159 F. (2d) at page 345.)[39]

[39] As to the equitable principles which the court held also required prohibition of compensation to Mr. Evans, it said:

"It will be noted that we have regarded Mrs. Evans' transactions as being in the same category as those of Mr. Evans. While she financed her securities dealings entirely with her own funds, Mr. Evans candidly stated that she engaged in the various transactions with his 'entire approval and knowledge.' Under such circumstances it is clear that the bankruptcy court was justified, in the exercise of its proper powers, in extending the principles applicable to the conduct of the fiduciary to the fiduciary's wife. The settled rule in equity is that where a fiduciary is barred from compensation the prohibition extends to his wife: *Holman v. Ryan,* 1932, 61 App. D.C. 10, 56 F. (2d) 307, 311 and cases collected in 131 A.L.R. 990 (1940)." (159 F. (2d) at page 347).

In this aspect the *Midland United* case is in accord with *Berner v. Equitable Office Bldg. Corporation,* 175 F. (2d) 218 (1949), in which the opinion was written by Chief Judge Learned Hand. In that case the court referred to the *Midland United* case as establishing that "in some jurisdictions a purchase by the trustee's wife is ipso facto invalid" (page 221). The court did not agree with this construction of Section 249, but held that:

"Even were this not a general principle of the law of trusts, since Congress has seen fit in corporate reorganizations to impose so drastic a penalty as the forfeiture of all compensation upon any purchase whatever by an attorney—or other fiduciary—on his own account, we should fail to give proper scope to that purpose, if we were to say that he might freely favor a relative, or indeed even a friend, with information of a probable rise in price of the debtor's shares which was unknown to the shareholders. We hold that

In this case the Court of Appeals refused to apply Section 212 to these claimants despite the fact that they are related to Mr. Schroeder as closely as Mrs. Evans was to Mr. Evans in that case. It is submitted that the decisions are therefore in conflict because the same tests should be applied with respect to the limitation of claims under Section 212 as are applied with respect to the denial of compensation under Section 249.

At the time that the present Bankruptcy Act containing Sections 212 and 249 was adopted, Congress considered that the jurisdiction and powers of the Bankruptcy Courts "were still far too restricted to afford adequate relief" under the existing law, and that there was a "lack of adequate judicial control".[40] The legislative objective was to broaden the control of the court over all aspects of the reorganization proceedings, and the result was the passage of Sections 209-213 and 249, all of which were designed to accomplish that objective.[41] "The legislative intention was that these powers should be employed wherever necessary to protect the rights of the individual investor."[42]

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this is what Berner did, and that in so doing he committed a breach of trust to the shareholders of whom Bell bought. Nevertheless, since Congress limited the penalty of entire forfeiture to purchases by a fiduciary, we should not be warranted in extending that penalty to the situation at bar; and we think that the consequences should be only those which attend any breach of trust in equity: i.e., that in determining what the trustee's compensation shall be, the court will as a matter of discretion diminish the allowance which it would otherwise make, in proportion to the gravity of the breach." (175 F. (2d) at pages 221-222).

[40] House Report No. 1409, 75th Cong., 1st Sess. (1937), p. 37.

[41] 6 *Collier on Bankruptcy*, 14th ed., Sec. 9.28, pp. 2920-2922, and Sec. 13.18, pp. 4584-4585.

[42] *Ibid*, pp. 2921-2922. The same author further states (page 4590):

"Considering the rigorous purpose of the statute and the realities of life, the preferable view would seem to be that aside from ex-

Since the two sections were enacted for the same purpose, they should receive the same construction. They are alike in that neither mentions close relatives of the various types of fiduciaries who are mentioned. They are alike in that both had the effect of broadening the powers of the court.[43]

It has been said that "Chapter X enables the reorganization judge to exact of representative agencies or bodies a standard of personnel and conduct which attains the fullest measure of protection to the principal, secures a conscientious representation of his interests, and which is responsive to his rights and needs alone."[44] If Section 249 has that effect by virtue of prohibiting compensation to a fiduciary whose close relatives trade in the debtor's securities, will not Section 212 have precisely the same effect if it is construed to prohibit those same persons from reaping profits with the aid of the fiduciary? What essential difference is there, if the matter is viewed realistically, between denying him compensation because he assisted his wife in trading in his debtor's securities, and denying her the fruits of such trading for exactly the same reason? Can anyone seriously contend that his knowledge that either one of those consequences would follow from his participation in his wife's trading would not have the same effect as knowledge of the other, namely, to tend to cause him not to trade in the securities of his trust?

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ceptional circumstances—as, for example, an estranged spouse trading in the securities independently—such transactions should be disqualifying; otherwise 'a fertile field would be opened to a fiduciary to profit the members of his family and thus enhance his own economic position by reason of his status as a beneficiary'."

[43] 6 *Collier on Bankruptcy,* 14th ed., Sec. 9.31, p. 2929, and Sec. 13.18, pp. 4584-4586.

[44] *Ibid,* Sec. 9.31, pp. 2933-2934.

That is the heart of the matter. Section 212 must be construed the same as Section 249 because only if it is so construed will it fully accomplish its purpose. If it is not so construed, this is what a fiduciary could do if his knowledge of the debtor indicated that there was a profit to be made in its securities: He could make a large gift to his wife, and thus provide her with funds to be used in trading in the debtor's securities; he could purchase such securities for her, using her funds, and thus produce a profit of many times the amount of compensation he could expect to receive for his services; and then he could waive his claim for compensation, knowing that it would be disallowed anyway under Section 249 as that section has been construed, and go on his way, laughing at Congress and the safeguards it sought to place in the Bankruptcy Act.

It is therefore submitted that, since Section 212 and Section 249 must both be construed to apply to a situation in which a fiduciary participates in trading by his family, the decision of the Court of Appeals in this case is in conflict with the decision of the Court of Appeals for the Third Circuit in *In re Midland United Co.* This provides a third reason why this Court should review this case.

CONCLUSION

It is submitted that there are three valid reasons why this Court should grant certiorari in this case:

1. Because this case presents a question which (a) has great importance in the administration of the Bankruptcy Act; (b) should be finally settled by this Court; (c) has been decided by the Court of Appeals for the Seventh Circuit in a way which is inconsistent with the governing principles laid down by this Court; and (d) has been

decided in a way which conflicts with decisions of other Courts of Appeals.

2. Because the decision in this case is in conflict with decisions of the Courts of Appeals for the Second and Sixth Circuits; and the latter are consistent with the decisions of this Court.

3. Because the decision in this case is contrary to a decision of the Court of Appeals for the Third Circuit; and the latter gives effect to the purpose for which Sections 212 and 249 of the Bankruptcy Act were adopted.

Dated at Milwaukee, Wisconsin, April 14, 1950.

Respectfully submitted,

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JACKSON M. BRUCE,
Of Counsel.

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CHARLES ELMORE CR
OF

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1949.

Nos. 761-762

IN THE MATTER OF
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Debtor.

JOHN W. EMMERLING, TRUSTEE OF FRANKLIN BUILDING COMPANY,
Petitioner,
vs.
ROBERT W. SCHROEDER,
Respondent.

JOHN W. EMMERLING, TRUSTEE OF FRANKLIN BUILDING COMPANY,
Petitioner,
vs.
MOLLIE SCHROEDER AND JUNE KUPTZ,
Respondents.

REPLY BRIEF OF PETITIONER

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HAMMERSMITH-KORTMEYER CO. MILWAUKEE

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REPLY BRIEF OF PETITIONER

ARGUMENT

The divisions of the brief of respondents in opposition to Petition for Certiorari correspond to those in the brief in support of the petition except that parts II and III of the latter are both discussed in part II of the former. The divisions of this reply brief adopt the organization of respondent's brief.

I.

MANUFACTURERS TRUST COMPANY v. BECKER DOES NOT GOVERN THIS CASE

Part I of respondents' brief is devoted to a discussion of part I of petitioner's brief. The argument made depends almost entirely upon *Manufacturers Trust Company v. Becker,* 338 U.S. 304 (1949), and is in general based upon the proposition that that case governs this case. Counsel for respondents concedes that this case involves the same question of law which was left undecided in the *Becker* case, namely, whether the claims of close relatives of a fiduciary should be limited to cost when it appears that the fiduciary purchased their bonds for them either pursuant to a joint enterprise in which he and they participated or as their agent acting under broad express authority. However, it is contended that the *Becker* case now establishes that the conduct of the fiduciary himself was proper, and that therefore this question should again be left undecided in this case.

It is submitted that the *Becker* case does not govern this case as to the points for which counsel cites it because the undisputed material facts in this case are substantially different from those in that case; and, further, because this Court was very careful in its decision to prevent extension of the principles laid down to situations like that in the case at bar. (It should also be pointed out that the conduct of this particular fiduciary, William A. Schroeder, was held by the District Court to be improper (R. 177), and his claim was limited as to his own bonds (R. 183-185); there has been no appeal from that determination. The only question remaining here is whether the result can be different as to his wife, son, and daughter.)

Both the District Court (R. 177) and the Court of Appeals (R. 206) considered that there was applicable to the fiduciaries in this case the rule of *Magruder v. Drury*, 235 U.S. 106 (1914), that a trustee shall not be allowed to profit from his trust. In that respect both courts were clearly correct, as this case does involve an express trust which was created by the Trust Agreement (Ex. 3) under which the Bondholders Committee operated the debtor's business for some fifteen years. William A. Schroeder, as the managing agent employed by the committee, was of course also a fiduciary and subject to the same rule of law, as the District Court ruled. Therein lies one of the important distinctions between the *Becker* case and this case; for in that case the persons involved were not trustees of an express trust, but director of a going business, and this Court accordingly expressly held that the rule of *Magruder v. Drury* was inapplicable.

Another distinction between the *Becker* case and this case is implicit in the great differences in the financial condition of the two debtor corporations. Counsel for respondent states that the opinion in that case "made it clear that the status of the corporation as a going concern is a matter of much importance in the consideration of fiduciary duties" (Br. 10). As a matter of fact, his statement might have been made more positively; for it is clear from the opinion that the result would have been different if the debtor in that case had not been a going concern at the time the securities in question were purchased. Furthermore, in the concluding paragraph of the opinion this Court clearly implied that it might well have reached a different conclusion "if in fact liquidation had been imminent at the time of respondents' purchases". Thus, the *Becker* case might be summarized as holding (as to corporate directors) that in the typical case of a

corporation which was at one time solvent, which has become insolvent but remains a going concern, and the financial condition of which is progressively becoming poorer so that it is becoming less and less a going concern and more and more a prospective subject for judicial relief, the directors may trade in its securities even after it becomes insolvent provided that it remains a going concern; but there is no implication that they may do so after the corporation has become so little a going concern and so much a prospective subject for judicial relief that a conflict of interests would arise from their purchases, or after liquidation has become imminent.

Here there is presented the case of a corporation which never even became a going concern—a corporation which was operated by trustees for the benefit of its creditors for a period of some 15 years before it even became a prospective subject for judicial relief—a corporation the liquidation of which was imminent, or at least a clear and present danger, during all of the years from 1932 to 1947. The facts as to the financial condition of this corporation are summarized at pages 8 through 14 in the statement of the case of the brief in support of the petition for certiorari. They show that Franklin Building Company never even completed the building which it was formed to erect; that within a few years after it commenced doing business it had defaulted on its bond issues, and as a result one bondholder had in 1932 brought action upon his bonds and tied up all of the income of the company by garnishment; that thereafter the business was operated at a loss during each and every year, including 1947; that finally in that year the condition of the company had *improved* sufficiently to make it a subject for judicial relief by way of reorganization.

These facts are the reverse of the facts in the *Becker* case. These facts make it clear that a conflict of interests was necessarily created whenever any of the fiduciaries operating the company for its creditors traded in its securities. Counsel seeks to draw a parallel between the cases, and to make the condition of this company appear sound, by referring to the payment of back taxes and the completion of the building "out of current earnings alone" (Br. 10); but the fact remains that there were no net earnings when the interest due to the bondholders is taken into account. Actually, what in effect happened during the years from 1932 to 1947 was that the bondholders devoted money that was due them as interest to the payment of those old obligations of the company, which can hardly be called the normal way of operating a going business. The deficit account of the company's business increased every single year by the amount of the net loss shown in the table on page 12 of the brief in support of the petition, and every penny of those losses came out of the pockets of the bondholders. That being the case, at every instant for a period of fifteen years there was before the persons in control of debtor's business the question of whether it was better to continue operations or to liquidate the assets. True, progress was made in reducing certain other obligations; but were the bondholders better off at the end of 1939, for instance, than at the beginning of that year, when all that was accomplished in the interim was reducing delinquent taxes by $5,500 while they lost nearly three times as much in interest? It would not be fair to judge the value of the committee's efforts by the use of "hindsight"; but questions such as that clearly demonstrate that a conflict of interests was created whenever one of the persons in charge of debtor's affairs traded in its securities during those years.

Counsel recognizes that in the *Becker* case this court paid attention to the rule enforced in the lower Federal courts, that a fiduciary may not purchase securities of the debtor corporation "after judicial proceedings for the relief of a debtor are expected or have been begun" (Br. 11-12). He seeks to avoid this rule upon the ground that the 1943-1947 reorganization proceedings, which were pending while nearly all of the bonds of these respondents were purchased, were not brought in good faith and were "a part of the very program of wrecking the debtor corporation" which he attributes to certain sinister persons. This rule of the lower Federal courts, of course, contains no exception as to proceedings instituted by persons whose opinions may be different from those of the persons in control of the debtor; instead, it is grounded upon the necessity of preserving the integrity and loyalty of persons who are in charge of a corporation which is in the custody of the court. Considerations such as this, going to the very basis of the control of a court over its proceedings, should not be cast aside because of the identity of the persons who institute those proceedings.

Furthermore, counsel's reasoning does not go far enough in this case. He makes mention of the fact that Robert Schroeder purchased the bonds of the plaintiffs in the 1943-1947 proceedings, but he does not mention the fact that that purchase occurred on February 25, 1946. There is not much reason for supposing that those persons were very dangerous thereafter, and in fact there is no reason whatever for not applying the rule to the bonds of these respondents which were purchased on and after that date and which amount to 86% of their total purchases during the years 1943-1947 (see table, pp. 14-16, brief in support of petition).

In view of these considerations and particularly in light of the care which this court took in framing its opinion in the *Becker* case in such a way that it would not be extended to other and different cases, it is submitted that that decision does not in any way justify William Schroeder's conduct in trading in the securities of his trust for the benefit of his family. Rather, this case is of the type this Court had in mind which it stated that it "has recognized that equity must apply not only the doctrines of unjust enrichment when fiduciaries have yielded to the temptation of self-interest but also a standard of loyalty which will prevent a conflict of interests from arising." No such standard has been applied in this case; a conflict of interests did arise when William Schroeder traded in debtor's bonds; and it is accordingly submitted that the decision in the *Becker* case cannot in any way be said to approve of conduct like that of the husband and father of these respondents.

II.

THE DECISION IN THIS CASE CANNOT BE RECONCILED WITH THE CITED DECISIONS OF THE COURTS OF APPEALS FOR THE SECOND, THIRD, AND SIXTH CIRCUITS

In Part II of respondents' brief an attempt is made to reconcile the decision of the Court of Appeals for the Seventh Circuit in this case with the decisions for the Courts of Appeals for the Second and Sixth Circuits discussed in Part II of the brief in support of the petition and with the decision of the Court of Appeals for the Third Circuit discussed in Part III of the brief in support of the petition. It is stated that no conflicts whatever exist between the decision in this case on the one hand and the decisions in those cases on the other hand.

Irving Trust Co.v. Deutsch, 73 F. (2d) 121 (C.C.A. 2, 1934), cert. den *sub nom. Bell v. Irving Trust Co.,* 294 U.S. 709, followed the rule that "one who knowingly joins a fiduciary in an enterprise where the personal interest of the latter is or may be antagonistic to his trust becomes jointly and severally liable with him for the benefits of the enterprise" (73 F. (2d) at p. 125). The argument made to reconcile that principle with this case is "that the petitioner assumes that the respondents were engaged with William A. Schroeder in a joint enterprise and that they knowingly joined with him, a fiduciary, in breaches of his trust", and that such "assumption begs the whole question." The question begged is said to be "whether the purchases of bonds by the respondents constituted a violation of the duty of a fiduciary" (Br. 16).

It is submitted that in advancing this argument counsel for the respondents misconceives both the rule of the *Irving Trust Co.* case and the position of the petitioner. That case did not require that the purchases constitute breaches of trust, but simply that they involve a situation in which "the personal interest of the latter [fiduciary] is or may be antagonistic to his trust". It would seem to be beyond dispute that when a trustee purchases securities for himself and for members of his family, deciding among them as to who shall be the ultimate owners of the bonds simply on the basis of "who had too much cash" (R. 112), his personal interest is or may be antagonistic to his trust.

But in any event the purchases were not purchases "by the respondents". Let there be no mistake about the fact that William A. Schroeder bought these bonds for these respondents, as all of the evidence makes perfectly plain (R. 55, 57-58, 62-63, 65, 68-72, 71, 96-97, 100). And his purchases of their bonds for the respondents were

breaches of his trust to exactly the same extent that his purchases of his own bonds were. Counsel states that no authority is cited for that proposition; but attention is called to the authorities on page 25 of the brief in support of the petition, which are referred to in a footnote at the very beginning of the argument on this point on page 30.

Therefore, whether these purchases be regarded as breaches of trust or simply as transactions in which William Schroeder's personal interest was or may have been antagonistic to his trust, they are squarely within the rule of *Irving Trust Co. v. Deutsch* and approval of them is in conflict with the decision in that case.

At page 17 of the brief it is asserted that the *Becker* case "is a square holding" to the effect that a fiduciary who is not allowed to purchase bonds for himself nevertheless is permitted to act as agent for others in purchasing bonds for them. In fact the *Becker* case held no such thing, for the court concluded that the purchases of the fiduciaries for themselves were proper and therefore said "it becomes unnecessary to determine whether the relation of the Becker respondents to the directors was such as to require limitation of these respondents' claims * * * " (footnote 16).

Counsel also takes issue with characterizing the operations of the Schroeder family as a joint enterprise (Br. 18-19), which, as was pointed out in the argument in support of the petition (pp. 26-27) need not be established in view of the undisputed principal-agent relationship. But the attempt to disprove the joint enterprise consists simply of emphasizing the *present* occupations and places of abode of Robert Schroeder and June Kuptz and attempting to show that the four people were all

individuals, which of course is always true by definition of the members of a joint enterprise.

Counsel also says that this case is entirely different from *In re Van Sweringen Co.*, 119 F. (2d) 231 (C.C.A. 6, 1941), cert den *sub nom. Terminal & Shaker Heights Realty Co. v. Van Sweringen Co.*, 314 U.S. 671, which is in accord with the *Irving Trust Co.* case, but cites no reason why the principle of that case should not have been applied in this case.

The same is true of the case as to Section 249 of the Bankruptcy Act discussed in Part III of petitioner's brief, *In re Midland United Co.*, 159 F. (2d) 340 (C.C.A. 3, 1947). Aside from pointing out the differences in the wording of Sections 212 and 249, counsel makes no argument in opposition to the reasons cited in the brief in support of the petition which show why those two sections should be construed in the same way.

CONCLUSION

The respondents take no issue with the position of the petitioner that this case presents a question which (a) has great importance in the administration of the Bankruptcy Act; (b) should be finally settled by this Court; and (c) has been decided by the Court of Appeals for the Seventh Circuit in a way which is inconsistent with the governing principles laid down by this Court. Instead, the attempt is to demonstrate that this question need not be decided at all because of a lot of altruistic motives which are ascribed to respondents, to a large extent without support in the Record. This is not an appropriate stage of the proceedings at which to analyze the evidence as to their state of mind. It is sufficient to point out that the question remains regard-

less of respondents' motives, and drawing attention to those merely adds to the main question a secondary one, namely, whether motives are material.

The respondents do attempt to reconcile the decision in this case with contrary decisions of other Courts of Appeals; but this effort again is largely devoted to arguing that the principles of those cases have no application to this case because these claimants were engaged in thwarting the evil purposes of certain sinister "outsiders", although those persons were also bondholders and no reason is suggested why the District Court would not be able to safeguard the interests of all parties in the reorganization proceedings which they instituted.

Essentially this case presents but one question, regardless of the attempts made to give it a different appearance. That question is whether a fiduciary can, pursuant to plan, benefit members of his immediate family by purchasing for them the securities of his trust, when he is forbidden to do the same thing for himself. That question merits final determination by this Court, and the petition should accordingly be granted.

Dated at Milwaukee, Wisconsin, May 19, 1950.

Respectfully submitted,

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In the Supreme Court of the United States

October Term, 1949 - - - Numbers 761-762

JOHN W. EMMERLING, Trustee of Franklin Building Company,

Petitioner,

vs.

ROBERT W. SCHROEDER,

Respondent.

JOHN W. EMMERLING, Trustee of Franklin Building Company,

Petitioner,

vs.

MOLLIE SCHROEDER and JUNE KUPTZ

Respondents.

Brief of Respondents in Opposition to Petition for Certiorari.

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SUMMARY OF ARGUMENT.

I. This case does not involve a new question of federal law but merely a few unimportant variations from the situation in which this Court settled the law less than six months ago in *Manufacturers' Trust Co. vs. Becker*, 338 U. S. 304 6

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AUTHORITIES.

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THE OPINIONS IN THE COURTS BELOW.

The opinion of the Court of Appeals for the Seventh Circuit is reported in 178 F. (2d) 805, and appears in the present Record at pages 203 and 209. The opinion of the

District Court for the Eastern District of Wisconsin is reported in 83 F. Supp. 263 and appears in the present Record at pages 173 to 180.

JURISDICTION.

Jurisdiction of this Court is invoked by the petitioner under 28 U. S. Code 1254.

STATEMENT OF THE CASE.

The petitioner's statement of the case omits to mention a substantial part of the facts on which the District Court and the Court of Appeals for the Seventh Circuit concluded that the participation of the respondents should not be limited to the purchase price of their bonds.

Mollie Schroeder is the wife, and June Kuptz and Robert W. Schroeder are the adult children of William A. Schroeder, who was a large stockholder and a second mortgage bondholder of Franklin Building Company. (R. 82, 83) William A. Schroeder's investment in these securities has been completely wiped out (R. 115), but the first mortgage bondholders will receive their principal in full and a substantial amount of interest. The wife and daughter of William A. Schroeder never held any office in the corporation, were never members of the Bondholders' Committee, and never occupied any fiduciary relation toward the corporation or its bondholders. The same is true of the son Robert, except that he became a member of the Bondholders' Committee after the present reorganization proceeding was commenced (R. 52) and more than a year after he made his last purchase of first mortgage bonds. (R. 69, Exhibit O)

In September 1932 the condition of the Franklin Building Company was very precarious. The office building

which it had constructed on leased land was only partly finished, the real estate taxes were delinquent to the extent of $13,000, the corporation had no funds and its rents were garnisheed, and the gas and electric service were about to be cut off for nonpayment of bills. (R. 39, 153) At this juncture a first mortgage bondholders' committee was organized and the operation of the building was turned over to a trustee who was a member of that committee. (R. 24, 25) Thereupon William A. Schroeder, who was president of the corporation, ceased to have any connection with the management of the property, and the corporation itself became dormant though its corporate existence was not terminated and its officers remained nominally in office. (R. 110) During the next five years the delinquent tax bill increased to $42,000 (R. 39), but the Bondholders' Committee through its trustee operated the building and made sufficient payments on the back taxes to keep the City of Milwaukee from taking the property; but in 1937 the situation again became very acute, with the City threatening an immediate receivership (R. 87), and the Committee concluded to enlist the services of William A. Schroeder as rental agent of the property. (R. 87, 152) He accepted the appointment and continued in that capacity for the next ten years, until the present proceeding was instituted in 1947, and thereafter was retained as managing agent by the trustee in the reorganization proceeding. (R. 82) During the period of his management the net earnings of the building were continually devoted to the payment of taxes and the completion of the physical structure, until at the commencement of the present proceeding the enterprise was free of tax delinquency and had practically no current indebtedness, and had some $20,000 of cash in the bank. (R. 3) However, its $244,400 of first mortgage bonds and $50,000 of second mortgage bonds, together with acrued interest of about one hundred per cent

on each bond issue, amounted to nearly twice the value of the building (R. 3) and made a Chapter X reorganization inevitable. In the course of the reorganization, the building was sold by the trustee for $325,000 (R. 94), which will pay out the $185,300 of first mortgage bonds on which claims were filed (R. 133) at par plus about forty per cent interest. (Petition for certiorari, page 3)

The statement on pages 11 and 12 of the petitioner's brief that the debtor operated at a net loss every year from 1932 to 1947 is based on charging full bond interest, amortization of the 99-year lease, and depreciation of the building, as operating expenses before net profit or loss is determined. In actual fact, the operation of the debtor's property during the period of William A. Schroeder's management from 1937 to 1947 was highly successful in pulling the enterprise out of its immediate financial emergency, though it was clear from the outset that nothing was likely to be realized by the stockholders or the junior bondholders.

In November 1943, a group of individuals referred to in the record as the Ruppa-Dufenhorst group, who had acquired some of the first mortgage bonds, commenced an involuntary reorganization proceeding in the United States District Court, which was strenuously resisted by the Bondholders' Committee because it was not brought for the benefit of the bondholders but for the purpose of personal profit to the Ruppa-Dufenhorst group. (R. 87, 93) A sale of the building at that time would not have brought more than $75,000, or less than twenty-five cents on the dollar for the first mortgage bondholders after paying the taxes that were then still outstanding. (R. 94) Both William A. Schroeder and the members of the Bondholders' Committee were much disturbed by this Ruppa-Dufenhorst reorganization proceeding, as it seriously jeopardized their

program of nursing the enterprise back to a point where the first mortgage bondholders might be paid out in full. Accordingly they adopted a policy of trying to prevent any more of the first mortgage bonds from falling into unfriendly hands, first by strongly advising all bondholders with whom they came in contact to hold on to their bonds, and second by purchasing with their own individual funds the occasional bonds which would turn up in the hands of brokers for sale. (R. 37, 45, 107, 108)

In the case of the Schroeder family, the first purchases of bonds after the commencement of the Ruppa-Dufenhorst reorganization proceeding were made by Robert W. Schroeder, who was serving in the Navy after July 1, 1943, but who had left about $1,000 with his father for investment as his agent and kept remitting further funds to his father for the same purpose out of his Navy pay. (R. 53, 55) After his discharge from the Navy in December 1945 (R. 53), Robert returned to Milwaukee and entered upon the practice of law in his father's office (R. 63), and the two of them in February 1946 negotiated a purchase of the Ruppa-Dufenhorst bonds by Robert Schroeder at sixty cents on the dollar (R. 52, 56-57, 97), thereby putting an end to the threat caused by the reorganization proceeding that was still pending. Robert's last bond purchases were made in April and May 1946 from a broker. (R. 69, 71) All of his other purchases were made during the period of the Ruppa-Dufenhorst threat, except $1,100 par value which he bought at 9 cents on the dollar in 1942 from the state banking commission, which was liquidating a state bank. Robert was then a college student, working part-time in a factory. (R. 57, 70)

June Kuptz made her first purchase of bonds in May 1946 from a broker (R. 97), and she made further pur-

chases from him in March, April and June 1947. (R. 95-98) Her father acted as her agent in making all of her purchases, but the money was her own, which she had earned in government service during the war. (R. 99) She was married and living with her husband away from her father's home except for the period of her husband's military service and a short period after his return. (R. 100)

Mollie Schroeder's purchases of bonds were made in part through William A. Schroeder as her agent, and in part through Robert W. Schroeder as her agent, but with funds belonging solely to her. (R. 103) She was a school teacher for years before her marriage and had saved up some money, and when her husband "went broke" she again went to work. (R. 111)

ARGUMENT.

I.

This Case Does Not Involve a New Question of Federal Law But Merely a Few Unimportant Variations From the Situation in Which This Court Settled the Law Less Than Six Months Ago in Manufacturers' Trust Co. vs. Becker, 338 U. S. 304.

The effort of the petitioner to induce this Court to grant a writ of certiorari is grounded in part upon the claim that the present case involves new questions of law whose determination is of great importance in the administration of the arrangement and corporate reorganization provisions of the Bankruptcy Act. It is true, as counsel for the petitioner points out, that the question whether the members of the family of a fiduciary are sub-

ject to limitation of their claims merely by virtue of their relationship to the fiduciary is a question which has not been passed upon by this Court but was expressly left open in *Manufacturers' Trust Co. vs. Becker,* 338 U. S. 304, Footnote 16, 94 L. Ed. 99, 105, 70 Sup. Ct. 127, 133 (decided November 21, 1949). But the very reason for leaving the question open in the *Becker* case is equally present in the case at bar, namely, that under the evidence in the case, the conduct of the fiduciary himself was free from any taint of fraud or overreaching. Hence the present petition represents merely an effort to get the Court to go over once more the ground so recently covered in the *Becker* case upon a very similar state of facts.

This Court in the *Becker* case had before it findings of a referee which were an almost complete parallel to the facts on which Judge Duffy in the District Court and Judges Finnegan and Lindley in the Court of Appeals based their decision, in the case at bar, that the participation of the respondents should not be limited to their cost. The findings in the *Becker* case were summarized by this Court as follows (94 L. Ed. at page 103, 70 Sup. Ct. at page 130):

> "It was the referee's finding, left undisturbed by both courts below, that respondents' purchases were without overreaching or failure to disclose any material fact to the selling bondholders. Petitioner does not here contend that respondents' claims should be limited because of conduct by the Becker directors or by respondents amounting to bad faith or abuse of fiduciary advantage. Nor does petitioner contend that respondents' bondholders influenced the conduct of corporate affairs to the injury of the corporation or other creditors. Indeed, the referee

found that the purchases were not unfair to debtor, that at the time of respondents' purchases debtor was not in the field to settle its indebtedness on the debentures, and that the assistance rendered to debtor by respondents materially aided in its grave financial situation. Moreover, the findings indicate that the most generous suggestion of an offer for the apartment building after the Beckers became directors and prior to the sale was at a figure substantially less than the sale price."

With respect to these findings the Court, by Mr. Justice Clark, said (94 L. Ed. at pages 104, 105, 70 Sup. Ct. at pages 131, 132):

"When the transactions underlying respondents' claims here are drawn alongside a good faith standard of fiduciary obligation, they appear unobjectionable. There is no component of unfair dealing or bad faith. The findings negative any misrepresentation or deception, any utilization of inside knowledge or strategic position, or any rivalry with the corporation. During the period of the purchases the conduct of the Becker directors and of respondents with reference to the affairs of the debtor was to its substantial benefit and to the advantage of the other debenture holders. And there is nothing to suggest that had the debentures been acquired by the Becker directors, they would have been unjustly enriched. Cf. Securities and Exchange Commission vs. Chenery Corporation, supra, 318 U. S. at page 86, 63 S. Ct. at page 458, 87 L. Ed. 626. • • •

"Certainly the present record does not tend to establish that the opportunity for such purchases

during insolvency would deprive a going corporation of the sound judgment of its officer. *And in any event the potentiality of conflict must be weighed against the desirability of permitting reinforcement of the insolvent's position insofar as a director's acquisition of claims may help. On this record the probability that an actual conflict of loyalties arose from the opportunity to purchase respondents' claims, while the debtor was a going concern, is not great enough to justify the exercise of equity jurisdiction which petitioner urges.''*

Thus it is clear that the Court in the *Becker* case, upon an examination of the record, concluded that what had occurred in that particular case had had no wrongful results for which even the fiduciary himself, much less the mere relatives of the fiduciary, should be penalized. *Exactly the same situation exists in the present case.* Both the District Court and the Court of Appeals gave the case their careful scrutiny in an effort to ascertain whether any wrong had been done. Judge Duffy in the District Court examined into the "good faith situation now before the Court'' and concluded that the facts which we have detailed in our statement of the case justified the purchases of bonds by members of the Schroeder family as acts beneficial to the corporation and untainted by any violation of fiduciary obligation—assuming that such an obligation could exist at all on their part as mere relatives of a fiduciary. (R. 179; *Re Franklin Building Company,* 83 Fed. Supp. 263, 267) The Court of Appeals again examined the factual situation and the majority of the Court substantially repeated Judge Duffy's language in holding that there was no impropriety in the acts of Mrs. Schroeder or her children. (R. 207-208; *Re Franklin Building Co.,*

178 Fed. (2d) 805, 808) Judge Kerner, dissenting in the Court of Appeals, indicated no disagreement with the majority as to the propriety of the motives with which the purchases were made, but felt that the evidence indicated that bond purchases of the Schroeder family were a joint family enterprise directed by the fiduciary William A. Schroeder himself, hence he concluded that the members of the family were subject to the same strict rule which he assumed to be applicable to the actual fiduciary. (R. 208-209; 178 F. (2d) at p. 809) Neither the majority nor the minority of the Court of Appeals cited the *Becker* case, which had been decided by this Court just seventeen days before the decision of the Court of Appeals was filed.

Mr. Justice Clark, speaking for the Court in the *Becker* case, made it clear that the status of the corporation as a going concern is a matter of much importance in the consideration of fiduciary duties. Tested by the standard applied in the *Becker* case, the corporation here involved was emphatically a going concern throughout the period from 1941 to 1947 when the bond purchases in question were being made. True, the property was being operated by a bondholders' committee rather than by the officers and directors of the corporation, but it was a highly successful operation from the moment William A. Schroeder was called back into the management in 1937 after five years of floundering. (R. 152) He was able, *out of current earnings alone,* to pay not only the operating expenses as they accrued, but to pay up $42,000 of back taxes and devote nearly $100,000 to the completion of the building itself. (R. 39) The mere fact that interest was in default on the first and second mortgage bonds does not, of course, mean that the enterprise was not a going concern, any more than in the *Becker* case, where the interest

on the debentures was likewise in default. The very fact that the present reorganization will result in paying the first mortgage bondholders at least 140 per cent of their investment (Petition for Certiorari, page 3), as against the 43.61 per cent that was paid to the security holders in the *Becker* case (94 L. Ed. 101, 70 Sup. Ct. 129), is in itself an impressive tribute to the singleness of purpose with which William A. Schroeder managed the enterprise from the time he was brought back into the management in 1937 until the building was sold in 1947. His own investment, consisting of stock and second mortgage bonds, was a total loss, and in addition he accepted without complaint the decision of the District Court that his own purchases of $4,500 of first mortgage bonds—made with the same unselfish motive as those of his wife and children—should be repaid at his actual cost only; but he devoted ten years of his life to getting the property free from tax encumbrances, physically completed, and on a net earning basis of $25,000 per year (R. 87), for the sole benefit of the first mortgage bondholders other than himself. If Judge Duffy had had the benefit of the decision of this court in the *Becker* case—which had not yet been decided even in the Court of Appeals at the time he decided the case at bar—he no doubt would have allowed in full the claim of William A. Schroeder as well as the claims of his wife and children. This is mentioned lest it be inferred that because of William A. Schroeder's failure to appeal from the decision on his own claim, the members of his family may stand in a less favorable position than the relatives of the fiduciaries involved in the *Becker* case.

An attempt may be made to distinguish the *Becker* case from the case at bar by reason of the pendency of an involuntary petition for reorganization of the present debt-

or corporation during the period that the respondents were purchasing their bonds, thus bringing the present case (it might be argued) within the rule mentioned by Mr. Justice Clark as prevailing in the lower federal courts, that a fiduciary may not purchase securities of the debtor corporation "after judicial proceedings for the relief of a debtor are expected or have been begun." But the involuntary reorganization proceeding commenced in 1943 and dismissed in 1947 was, as Judge Duffy pointed out in his decision in the District Court, a part of the very program of wrecking the debtor corporation which was attempted by the socalled Ruppa-Dufenhorst group and was frustrated by the vigilance of the Schroeder family and a few others in preventing that group from acquiring additional bonds. Judge Duffy stated in his decision, referring to the 1943 proceeding:

> "There is much to indicate this proceeding was not a good-faith attempt to reorganize the debtor. The court refused to permit the management of the premises by the Bondholders' Committee to be disturbed. Due to that consideration and also because of the necessity of determining the ground rent for the ensuing years, the status quo was maintained and the proceeding was dismissed in 1947, at which time the bonds held by Ruppa and his associates were purchased." (R. pp. 179-180; 83 Fed. Supp. at p. 268)

The purchaser of these Ruppa bonds was Robert W. Schroeder, one of the present respondents, and his purchase relieved all of the first mortgage bondholders of the threat which had hung over them since 1943, that the property might be disposed of in a manner quite contrary to the interests of the bondholders.

It may be further argued that the decision in the *Becker* case loses some of its force here in view of the fact that the present case involves a Chapter X reorganization and therefore may be differentiated from the *Becker* case in view of the language in the closing paragraph of Mr. Justice Clark's opinion to the effect that in a Chapter X proceeding, "the Securities and Exchange Commission, acting as the statutory advisor to the court, would have been within its rightful function in submitting to the court the light of its experience on dealings of the general kind disclosed in this case. Here we have proven facts in a particular case, and not a body of evidence submitted by the Securities and Exchange Commission, presumably informed by expert understanding." The Securities and Exchange Commission did participate in the case at bar at all stages, but it presented no such body of evidence as Mr. Justice Clark referred to in the language just quoted. It produced no evidence at all. Its counsel attempted to have the factual circumstances surrounding the purchases of bonds by the Schroeder family excluded from the record entirely, and the following colloquy ensued between the court and the attorney for the Commission (R. 157):

> "Mr. Powers: I am going to raise the further objection, or the objection again, that the line of questioning or interrogatories is entirely irrelevant to the issues before this court.
>
> "The Court: I don't think you are right on that. Unfortunately, you must know, as the court knows, there are certain dynamiters that go around and buy up bonds and then try to hold up the concerns by threatening legal actions, and so forth. It is well known to this court because we have had trails of these fellows pass by here close on numerous occa-

sions. Now, I presume what they want to show, in view of the testimony they took before, was they didn't want some of these bonds to get in the hands of some of these fellows and in good faith bought them up. Now, can't they show that? Isn't that relevant?

"Mr. Powers: No, I think not, your honor.

"The Court: Well, I am going to permit it anyway."

Thus the issue was sharply drawn in the trial court, upon the objection of the Securities and Exchange Commission itself, as to whether the question at issue was to be decided by a rule of thumb without paying any attention to the surrounding circumstances in the particular case; and the subsequent decision of this court in the *Becker* case squarely upholds the action of the District Court in admitting and considering the evidence on that subject. If the Securities and Exchange Commission had any "body of evidence" available for submission as suggested by Mr. Justice Clark in the final paragraph of the opinion in the *Becker* case, the Commission refrained from giving the trial court the benefit thereof.

It is somewhat ironical to note that if Robert W. Schroeder had not purchased the Ruppa bonds, and they had continued in the ownership of the Ruppa group to the present time, the so-called profit which the trustee is so anxious to prevent Mr. Schroeder from receiving would have gone to the Ruppa group, whose purpose in acquiring the bonds was destructive while the purpose of Schroeder was constructive and beneficial to the interests of the bondholders as a whole. Not only that, the Ruppa group would have made a much greater profit than Robert W.

Schroeder can ever make, because Schroeder had to pay 60 cents on the dollar for these bonds which the Ruppa group had bought at a time when the prospects of the enterprise were so gloomy that the cost to the group must have been exceedingly low. The net result is, that if Schroeder were to be penalized for purchasing the bonds at a time when his father was a member of the Bondholders' Committee, his fellow bondholders would now receive the amount of that penalty as a pure windfall, toward which they made no contribution whatever, whereas if Schroeder had refrained from purchasing the bonds, the long-term bondholders would have missed the windfall completely and the profit would have accrued to the group whose motive, as described by Judge Duffy, was to "dynamite" the enterprise.

It is respectfully submitted that the granting of the petition for certiorari in the present case would not open the way for a determination of any question of law that would be helpful in the administration of Chapter X of the Bankruptcy Act, but would merely involve this court in the examination of a record to determine whether the Court might agree or disagree with the factual conclusions reached by both the District Court and the Court of Appeals upon that record.

II.

The Alleged Conflict Between the Seventh Circuit and the Second, Third, and Sixth Circuits Does Not Exist.

A second ground on which the petitioner seeks to have the writ of certiorari issued is that the decision below

is said to raise a conflict between the Seventh Circuit on the one hand and the Second, Third and Sixth Circuits on the other.

In actual fact no such conflict exists. The Second Circuit has held, in a case not involving a corporate reorganization, that where directors of a corporation purchase for themselves certain stock which has been offered to the corporation and is needed in its business, and large profits are subsequently made upon the stock, not only the directors themselves but the agent whom they employed to procure the offer of the stock and who joined with them in making the improper purchase, are liable to the corporation for the profits realized. *Irving Trust Co. vs. Deutsch*, 73 Fed. (2d) 121 (C. C. A. (2d) 1934. The principle of law followed in that case as to the agent who joined with the directors was that "one who knowingly joins a fiduciary in an enterprise where the personal interest of the latter is or may be antagonistic to his trust, becomes jointly and severally liable with him for the profits of the enterprise." 73 Fed. (2d) at p. 125.

To say that the Seventh Circuit in deciding the case at bar was denying the principle of law just quoted is to disregard the whole factual setting of the present case. The petitioner's assumption is that the respondents were engaged with William A. Schroeder in a joint enterprise and that they knowingly joined with him, a fiduciary, in breaches of his trust. That assumption begs the whole question. The very thing that the courts below had to decide was whether the purchases of bonds by the respondents constituted a violation of the duty of a fiduciary. It is true that William A. Schroeder acted as the agent of the respondents in the purchase of a portion of their bonds, but the petitioner cites no authority for the assertion that a fiduciary who is denied the opportunity

to make a profit for himself in purchasing bonds of the debtor, is likewise barred from acting as an agent for others in the purchase of such bonds with their money and for their benefit. The recent decision of this court in *Manufacturers' Trust Co. vs. Becker*, 338 U. S. 304, is a square holding to the contrary, for in that case the court stated that the debentures of the relatives were purchased "through the agency of the Becker brothers [the fiduciaries] and in the latter's judgment" (94 L. Ed. at p. 102, 70 S. Ct. at p. 130); yet that fact did not weigh against the allowance of the claims of these relatives in full.

Petitioner's argument under this heading appears to be that, conceding that the respondents never occupied a fiduciary position and thus were under no inhibition against buying bonds of the debtor if they had gone directly to the brokers, their purchases were made wrongful by the fact that the brokers offered the bonds to William A. Schroeder and he accepted the offers as the agent of his wife and children. Much is said in the brief about the use of "inside information", and every effort is made to give the transactions a sinister appearance. But the fact remains that the testimony shows without dispute that the calls from the brokers came to the office of the building company because that was the place where the brokers would naturally apply first when seeking a customer (R. 92, 108); that after the commencement of the 1943 reorganization proceeding which threatened to wreck the whole program of rehabilitation, William A. Schroeder encouraged the brokers to apply first at the office of the building in order to keep the bonds out of unfriendly hands (R. 108); and that his motive in so doing was the protection of the first mortgage bondholders against "rocking the boat" at a time when it might have been disastrous. (R. 92) Conduct so motivated calls for commen-

dation, not punishment. Such, in fact, is the substantive law of Wisconsin, the respondents' home state. *McGeoch Building Co. vs. Dick & Reuteman Co.*, 253 Wis. 166 (1948). In the cited case the Wisconsin Supreme Court said at page 177:

> "In the instant case the trustee bought the bonds with the knowledge of the mortgagor, did not solicit them from among bondholders and bought them under circumstances that benefited both the bondholders and the mortgagor. The bondholders were protected by the maintenance of a market for the bonds. The mortgagor was protected by having the bonds in friendly hands. No harm is shown to have resulted. The trustee has not been guilty of any breach of contract, and no reason exists in the broader field of equity for finding any breach of fiduciary duty necessitating appellants' giving to respondent the earnings made by appellants by buying the bonds they did."

Counsel for the petitioner (Brief, pp. 2, 23, 31) repeatedly characterizes the bond purchases of the appellees as "a family enterprise" or "a joint enterprise"; but such an appellation is justified only if based upon evidence, and the evidence in the present case is all the other way. It is established without contradiction that the appellees all had separate estates of their own, derived from their own earnings. They used these separate estates in purchasing the bonds. June Kuptz is married and lives with her husband, away from the William A. Schroeder home, though she returned to her father's home for a time while her husband was in military service. (R. 100) Robert W. Schroeder is married and lives with his wife at the home of her parents (p. 77), and is an assistant district

attorney of Milwaukee County and national adjutant of one veterans' organization and state commander of another. (R. 64, 78) Mollie Schroeder, although of course a member of her husband's household, has always had assets of her own dating from a period prior to her marriage. (R. 117) These people are all individuals in their own right, with their own separate interests, resources and investments. They invested in the bonds of the debtor corporation their own hard-earned money, not any funds received directly or indirectly from the fiduciary William A. Schroeder.

The circumstances of the case at bar are so completely different from those involved in the Second Circuit case, *Irving Trust Co. vs. Deutsch,* 73 Fed. (2d) 121, that there never was any occasion in the present case for the Court to consider the rule of law which governed the Second Circuit case. There is no reason to believe that the Seventh Circuit would fail to follow that rule of law in a case properly involving its application. Paragraph 5(b) of Rule 38 of this Court provides for the granting of certiorari where the court below "has rendered a decision in conflict with a decision of another circuit court of appeals *on the same matter.*" Under that rule, the Second Circuit decision furnishes no basis whatever for granting certiorari in the present case.

The same is equally true of the decision cited by the petitioner from the Sixth Circuit, *Re Van Sweringen Co.,* 119 Fed. (2d) 231 (1941) In that case the District Court found "that Midamerica Corporation was a combination in corporate form, participated in by directors of the respective debtor corporations, formed and utilized for the purpose, among other things, of divesting the debtor corporations of their properties or of obtaining claims against

them at a sacrifice for the profit of the combination at the expense and to the detriment of the debtor corporations." 119 Fed. (2d) at page 232. The Court held that two non-directors who joined with the directors of the debtor corporation in purchasing claims against it at a discount for the joint benefit of all of the conspirators, were properly held to their actual cost in the distribution of the debtor's assets, the same as the directors themselves. As the Court said, "it is apparent here that the cupidity of persons in a fiduciary position has caused them to serve themselves in preference to those whom it was their duty to serve. Such dereliction is forbidden by just principles of law." 119 F. (2d) at page 235. To say that the Court of Appeals of the Seventh Circuit in the case at bar has repudiated the principle followed in the *Van Sweringen* case is simply to misread the decision of the court below and disregard the facts of the present case. There is no conflict whatever between the Seventh Circuit and the Sixth Circuit.

The third decision on which petitioner relies as establishing a conflict between circuits is that of the Third Circuit Court of Appeals in *Re Midland United Co.*, 159 Fed. (2d) 340 (1947). That case arose under the *mandatory* section 249 of the Bankruptcy Act (11 U. S. Code 649), which provides that *no compensation shall be allowed* to any committee or attorney or other fiduciary who, during the continuance of that capacity, has purchased claims or stock without the approval of the court. The District Court in Delaware had held this statute applicable to purchases made by the wife of an attorney in the reorganization proceeding. The Circuit Court of Appeals affirmed, Judge Goodrich dissenting with the remark that "nobody would, these days, fall back on the old common law unity of husband and wife now that a married woman may keep her own money, if she is lucky enough to have any,

and trade with it as she pleases." What the court was dealing with in the *Midland United* case was a statute relating to *compensation* for services rendered in the reorganization, which is a matter of Congressional grace rather than of right, whereas in the present case the petitioner is seeking *to deprive the respondents of a property interest which they have bought and paid for with their own money.* Anyone undertaking to work for a reorganization committee, either as a member or as an attorney, acquires only such right to compensation out of the fund in the hands of the court as the governing statute gives him. The question whether that statute shall be limited to its exact language or broadened by judicial interpretation is far different from the question whether individuals who have entered upon no fiduciary relationship shall be treated as fiduciaries against their will. In the *Midland United* case the dealings of the wife in securities of the debtor resulted in depriving the *fiduciary* of compensation, but no attempt was there made, as in the present case, to take away property owned by member of his family.

The statute under which the District Court was asked to limit the respondents' participation in the present case is very different from Sec. 249. It is Sec. 212 of the Bankruptcy Act (11 U. S. Code 612), which provides that the judge "may limit any claim or stock acquired by such person or committee in contemplation of or in the course of the proceeding under this chapter to actual consideration paid therefor." The "person or committee" is designated earlier in the sentence as "an agent, attorney, indenture trustee or committee [which] purports to represent any creditor or stockholder." The language of Sec. 212 is purely permissive, while that of Sec. 249 is mandatory. The petitioner claims that because the Court of Ap-

peals of the Third Circuit held the *mandatory* statute to be applicable to members of a fiduciary's family, while the Court of Appeals of the Seventh Circuit upon the facts of this particular case has refused to enforce the *permissive* statute against members of a fiduciary's family, a conflict exists between the two circuits.

Obviously there is no conflict. The decision of the Court of Appeals in the case at bar takes no position whatever as to whether Sec. 212 *could* be applied to the members of a fiduciary's family. That subject is nowhere mentioned in the decision. The Court simply held that the case before it was not a proper one for so applying the statute, because of the facts which the court reviewed at length. The question left open in *Manufacturers' Trust Co. vs. Becker,* 338 U. S. 304, as to whether members of a fiduciary's family may properly be limited to their cost, was likewise left open in the decision of the Court of Appeals in the case at bar. That decision would have been no different if the Court of Appeals had definitely concluded and had stated in so many words that Sec. 212 does apply to members of a fiduciary's family. So applied it would still be a permissive and not a mandatory statute, and the Court would have reached the same conclusion upon the facts of the case as it actually did reach. There was simply no necessity of deciding what persons Sec. 212 covers, because the case was found to be one that did not call for the imposition of the statutory penalty in any event.

The petitioner in his Brief (pages 20-21) conjures up all manner of evils that may arise if the relatives of a fiduciary are permitted to make a profit on securities of the debtor which they purchase. Both the District Court and the Court of Appeals are well satisfied that no such evils did arise in this case, but that fact, petitioner says, is im-

material because what is needed is a deterrent. This is but another way of insisting that the court must apply a rigid rule of thumb in every case. Had Congress so intended, it would have used in Sec. 212 the kind of mandatory language it used in Sec. 249. Congress deliberately made the action of the court in situations falling within Sec. 212 discretionary; and if there be situations that do not fall within Sec. 212 but are allegedly governed by some parallel general principle of equity, certainly no one can plausibly argue that the court must adhere to a rigid rule and *disregard* all equities. The ability of the trustee to close this reorganization with a feather in his cap, with every first mortgage bondholder paid his principal in full and some 40 per cent interest, is in no small part due to the vigilance of the Schroeder family in drying up the market for bonds which might otherwise have fallen into the hands of persons bent on tearing down the enterprise rather than building it up. The wife and children of William A. Schroeder were the only ones who had the resources to "hold the fort" in this manner during the critical days of the rehabilitation program; Schroeder himself had lost his entire investment in the enterprise as a stockholder and second mortgage bondholder, and was "broke" (R. 86), and was not able to assist in the effort until late in 1946 when he began to get back on his feet. (R. 112) He accepted with good grace the District Court's decision that his own purchases must be limited to his cost; yet the trustee insists that the courts should break new ground and inflict upon Schroeder's wife and children an unprecedented punishment for doing things that not only caused no injury to the first mortgage bondholders or anyone else, but helped to save the situation so that the trustee could carry to completion an entirely successful and creditable reorganization.

CONCLUSION.

It is respectfully submitted that the petitioner has made no case for the granting of a writ of certiorari, and that his petition should be denied.

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